

The Economic Situation at Midyear 1950

A Report to the President

By the

COUNCIL OF ECONOMIC ADVISERS

LETTER OF TRANSMITTAL

COUNCIL OF ECONOMIC ADVISERS,
Washington, D. C., July 24, 1950.

The PRESIDENT:

SIR: The Council of Economic Advisers herewith submits a report, The Economic Situation at Midyear 1950, in accordance with section 4 (c) (2) of the Employment Act of 1946.

Respectfully,

Leon A. Keyserling

Chairman.

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THE recent international developments require us to take stock of our economic position. This we propose to do in three parts: (1) A general interpretation of the economic events of the past five years and of their current significance; (2) an analysis of problems ahead and of desirable policies; and (3) a detailed description of economic trends during the first half of 1950.

I. Five Years in Retrospect

The need for an interpretive review of the past five years is enhanced, rather than reduced, by the foreign situation. The variety of problems which the economy has faced since VJ-day has been so broad, and the adjustments which have been made to these problems have been so significant, that they provide an excellent starting point for an appraisal of the existing situation and of desirable economic policy.

This is true because, during these five years, the United States economy has been tested by the difficulties of reconversion, inflation, and recession. It has surmounted these tests with relatively small hardships, measured by earlier history. There are now new problems confronting us. But the ability already displayed to cope with the various situations which have arisen since VJ-day should provide us with a practical understanding of the present and a good measure of guidance and confidence for the future.

Most indicators reveal the highest levels of peacetime prosperity yet achieved. Civilian employment reached almost 61½ million in June. The pulse of activity is strong in almost every important sector. Measured in 1949 prices, our total output of goods and services was running at an annual rate of about 267 billion dollars (268 billion in current prices) for the second quarter of 1950. This contrasts with an annual rate (also in 1949 prices) of about 151 billion in 1929, about 160 billion in 1939, about 254 billion in the lowest quarter of the 1949 recession, and about 259 billion in the previous peak reached in the fourth quarter of 1948. Even more important is the prospect that we shall move considerably higher in production and employment during the remainder of the year. This was in prospect even before the new international developments late in June.

The unusual speed and scope of the recovery from the recession of 1949 rounds out an extensive series of business changes since the war, in an economy vastly different not only in size but also in character from prewar. The economist is now challenged to make a fresh analysis, trained not upon the prewar situation, but rather upon a postwar economy which has

expanded far above prewar levels, and which has been altered in many respects by changes in structure and in business policies as well as by the legislative programs of the 1930's and by the fiscal policies of the postwar period.

It is true that the experience during these five years was not a complete test of our capacity to maintain maximum production without inflation or to avoid deep or prolonged downturns of business activity. Some temporary factors, carrying over from the war, were still available last year to provide some elements of strength which may not be present in the years ahead. The time may come, although it is not immediately in prospect, when we shall be put to a more searching test than in 1949 of our ability to substitute new factors of demand when older ones disappear or diminish. Should these circumstances arise, they may require more extensive business adjustments, and a different interplay of public policies, than those which proved so effective in 1949. Nor was the inflationary danger of 1946-49, which we surmounted, as great as might arise in the future. Nonetheless, the experience between 1945 and 1949 was of vital significance. During those years, we went through a range of events which would probably have been burdensome enough to generate serious and extensive economic troubles under earlier circumstances. The difficulties presented by that particular range of events have thus far been overcome successfully. This demonstrates that our economy has far greater elements of stability and strength than most people had supposed. We must build upon that strength.

Further, the current period is sufficiently remote from World War II to release us from most of the dangers to the economy which are inherent in a postwar readjustment. The high and increasing level of general prosperity which we enjoyed during the first half of this year, on a fairly stable basis, should now be placed in a new frame of reference and associated with a new set of data and problems. If that prosperity is menaced in the future, it will be less in consequence of some lingering problems of the past five years than in consequence of new developments with which we shall have to deal as they arise. This is strikingly true of the near future, in the face of an economic situation altered by the recent turn of international developments.

A review of the problems which have been met and surmounted since the end of the war will set in perspective the extent to which the first half of 1950, prior to the Korean developments, found us on much sounder economic ground than previously, with much improved ability and therefore greatly enlarged confidence to deal with whatever problems may arise in the future. More specifically, this review has a direct bearing upon the problems of the immediate future, when concern about inflation is again entering the public mind, and when the international situation necessitates a sharp increase in the output of some products.

FIVE PHASES OF POSTWAR ECONOMIC DEVELOPMENT

Within five years, we have experienced five business phases which have been clearly defined. It will be profitable to examine each of these in some detail.

The transitional phase: from the war's end to early 1946

The prevalent fear toward the war's end was that a drastic reduction in public outlays, plus the rapid demobilization of our armed forces, would lead to heavy unemployment and business dislocation for a substantial period of time. Many estimates of potential unemployment ran as high as 8 million.

This crisis did not materialize. True, by early 1946 industrial production had declined more than 30 percent from the May 1945 level, and employment in manufacturing had decreased more than 20 percent. Unemployment rose from about one-half million on VE-day to about 2.7 million in February 1946. But by the end of the first quarter of 1946, the post-hostilities decline was concluded.

The main reasons for the mitigation of demobilization dislocation resided both in public policy and in private action. On the public side, much legislation was enacted to speed industries through the recovery process and to make sure that they had ample funds for the work to be done. The payment of discharge allowances to veterans placed funds in the hands of those consumers who would most quickly spend them for civilian goods. Other programs were encouraging veterans by the hundreds of thousands to enter colleges and training schools; this had the effect of holding them temporarily off the labor market.

Even with these public policies at work, there could have been vast unemployment if industry had been unequal to the technical and managerial task of quick reconversion. But no such shortcoming appeared. Instead, business manifested great skill and celerity, displaying a genius no less notable than that which had converted the country to the tasks of war. The relatively quick composition of differences between management and labor was another factor. The process of reconversion was stimulated by the confidence that the markets were waiting for the goods to flow. There were vast reservoirs of funds in the hands of consumers and business to help maintain demand as war buying declined.

The great demand on the part of consumers and business for goods and services caused all producers to crowd the capacity of existing facilities. Extra shifts of workmen brought about an increase in the number employed, even before new capital investment was made feasible by increasing supplies of raw materials and building products.

The expansion phase: from early 1946 to late 1947

In this period, the expansion of production, employment, and personal income surged strongly forward. Unemployment dropped below 2 million. New capital investment began in earnest. The ending of price control in the second half of 1946 opened the way for a threatening cycle

of increasing prices, rising cost of living, aggressive and successful demands for higher wages, increasing costs of production, and again a rise in prices. But this process had little adverse effect upon production and consumption during 1946, which were dominated by accumulated consumer and business demand. The economy was carried to high prosperity levels and full employment by the end of 1946. By early 1947, it was obvious that we had entered into magnitudes of activity vastly higher than before the war. It soon became clear, also, that this was not purely a restocking boom. The high tempo of activity reflected profound changes throughout the entire economy, in its industrial capacity and productive potential, and in the size and distribution of currently earned national income.

In early 1947, however, many analysts had become somewhat pessimistic. They took the view that the growing volume of durable goods beginning to appear in the market would divert consumer buying from nondurables. This view proved to underestimate the total situation. By this time, foreign demand and the Government policy of assisting war-torn nations to rehabilitate their economies caused a tremendous increase of foreign buying in American markets. In the first half of 1947, our excess of exports of goods and services over imports mounted to an annual rate of 12 billion dollars. Exports of agricultural products were especially large. When it became apparent that this export surplus could not be maintained indefinitely, there were renewed declarations that a business slump was imminent. But new factors of strength appeared within the domestic economy. As the export surplus declined rapidly toward the end of 1947, capital investment by business expanded, home building increased, and the economy continued to move forward.

The increase in business expenditures for new nonagricultural plant and equipment, from an annual rate of 12.6 billion dollars in the first quarter of 1947 to an annual rate of 19.8 billion dollars in the final quarter of the year, was in itself enough to counterbalance the decrease in the export surplus. This was due, for the most part, to the normal reaction of business managers to mounting profits and to the vision of a vast market demand, buttressed by a great store of personal savings and by high and increasing personal income. Government policies gave support to the trend of capital investment. The management of the public debt was directed toward the stabilization of interest rates, with a view to maintaining a financial environment which would facilitate the great industrial capital expansion required in the postwar period.

Private residential construction accounted for about two-thirds of the increase of about 4 billion dollars in total private investment in new construction from 1946 to 1947. The credit policies and programs of Government played an indispensable part in the expansion of the market demand for homes. This expansion depended upon low interest rates, small or nominal down payments, and long periods of amortization. Without public assurances, the policies of private investment institutions could not have been extended far enough to permit this type of financing.

The combined efforts of private enterprise and Government were sufficient to dissipate the danger of large-scale unemployment and business dislocation during the reconversion period. It remained to be seen whether they could be equally successful in dealing with the postwar inflation.

The climax of inflation: from late 1947 to beginning of 1949

Toward the latter part of 1947, the postwar investment programs of business were in full swing, backed by ample funds and activated by the unexpected ease of reconversion. Characteristic of such periods, business investment at first increased much more rapidly than the output of industry. This rising investment, in turn, increased the spendable incomes of consumers. In addition, wartime savings were still large. The international situation required a high level of public outlays. Some restraints upon buying were available, but they were not adequate to deal with the mounting inflationary pressures.

Notwithstanding the jump in the demand for materials for home building and other construction and for new equipment, as well as an increase in personal consumption expenditures and employment, there was very little enlargement of industrial production from the first half of 1947 to the second half. At the same time, a short supply of some important farm products at home and abroad contributed to the excess of total demand over total supply. This situation was conducive to rapid price increases which began in July. Between June and December, the index (percent of the 1926 averages) of wholesale prices of goods other than farm and food products rose from 131.6 to 145.5. The index for farm products rose from 177.8 to 196.7, with parallel increases in the price of food products. Wage increases added to the pressure on costs and prices. In the third quarter of the year, business loans increased rapidly and bank deposits were correspondingly expanded.

By midyear 1947, wholesale prices had risen longer and further than they did after World War I. When prices continued to rise at an accelerated rate during the second half of the year, there was increasing concern. It was felt that the longer prices rose, the more serious would be the ultimate reversal in business conditions. Many programs to forestall another disastrous depression had been established during the 1930's. But they had not been tested. No one could be sure that they would be effective in controlling a downward trend, in a more dynamic economy which had been carried so far into inflationary dangers.

A first test, although not a complete one, of these anti-deflationary programs came early in 1948. Speculation in the grain markets had continued to drive grain prices upward until the middle of January 1948. After a period of two weeks in which quotations softened, the bottom dropped out of the market in much the same manner as in 1920, and the stage seemed to be set for a catastrophic decline in agricultural prices similar to that which, in 1920, had ushered in a serious postwar depression.

Two Government policies prevented a repetition of the 1920 collapse of agricultural markets. Most immediate was a limited control of trading practices in commodity markets, under which changes in prices in a single trading session were held to a narrow range, 10 cents per bushel in the case of wheat. For several successive trading sessions the price of wheat dropped the limit, and on February 13 reached a level 74 cents per bushel below the price a month earlier. This restrictive rule prevented a mass attack upon the market, however, and it forestalled utter demoralization.

Before farm income was significantly affected, the influence of a more important program, that to support farm prices, halted the market break. The farm price support program was valuable in stopping the drop in farm prices before any great damage had been done. It was even more important in preventing fear in the business world generally that an agricultural collapse was in the making which would be the prelude to a general deflation. For the business world had good cause to believe that 1920 would not repeat itself in a collapse of agricultural income. It was known that, long before farm income dropped to a point where the farmer would cease to be an important factor in the demand for manufactured and other goods, the program of supporting farm prices near a parity level would come into action.

These factors go far to explain why there was no break in industrial production or employment. Some industrial prices continued upward even while farm prices were falling. New business investment plans were carried through. There were no general declines in wholesale or retail price levels except in the case of farm and food products, and these quickly rallied. Industrial prices and profits continued to rise. New capital investment was expanding, following two years of heavy investment in enlarging productive facilities. Government expenditures were increasing because of the foreign situation. Nonagricultural employment was increasing, and unemployment in the second half of 1948 was as low as it had been in any corresponding period since the war. National income was establishing a new record in each successive quarter of the year. The total disposable income of consumers also rose steadily, in buying power as well as in dollars.

All these increases in demand were occurring during a period when some bottlenecks in the productive process had not yet been broken. The effect of large investment upon production had not yet made itself felt. In fact, during the last nine months of 1948, industrial production increased very little.

In late 1947 and during 1948, there were efforts to obtain a comprehensive program to deal with inflation. But these efforts were not successful, and the inflation ran its course, although it was modified by the Government surplus and debt-retirement policy.

In this quick survey of the inflationary movement, it is important to recall that there were some curbs upon the boom although they did not prove to

be sufficient. Even at the peak, speculation and business excesses were not comparable to those of earlier periods. Self-restraint was manifest in many quarters. Moreover, the banking and credit structure, changed in significant respects, did not fan the fires as in the late 1920's. The Government had some powers which were used to dampen buying and credit. This composite of private and public policies prevented the situation from getting out of hand. It helped to make the recession more controllable when it came.

The recessionary phase: the first seven months of 1949

The central cause for the recession was to be found in the unwillingness or inability of buyers of all types to absorb at current high prices the full product at full employment of a highly productive industry and a flourishing agriculture. That is probably a characteristic of almost all recessionary movements. This condition had first manifested itself, as at earlier times, in the agricultural sector. The great improvement in agricultural production at home and abroad led to a decline in farm prices. The index of prices received by farmers (percent of the 1910-14 average) had undergone a fairly unbroken decline from 297 in mid-July of 1948 to 255 in mid-February of 1949. The effect upon wholesale food prices was only slightly delayed, and their course paralleled that of farm prices. Retail prices responded more slowly. But the decline in retail food prices brought the forward movement of the consumers' price index to a halt in September 1948, and this index declined during the last quarter of the year despite a continued advance in prices of other consumer goods and services.

However, the farm situation, while a contributory factor, would probably alone not have brought on the general recession. There were more important developments in the relationship between the general price level for almost all types of goods and services, and the incomes and buying habits of consumers. Personal consumption expenditures dropped in the fourth quarter of 1948. In the meantime, it became apparent that output was going to increase if full employment were maintained. This trend, combined with the increasing price consciousness of consumers, altered the outlook of business regarding the supportability of maximum output and employment at the current price structure.

For nearly three years, merchants had been building up their inventories as rapidly as goods became available, because they were confident that they could rely upon maintenance of the existing market demand, and perhaps upon some further expansion, even at increasing prices. Toward the end of 1948, when that confidence was shaken, merchants began to reduce their orders for new goods to prevent further accumulation of inventories as expansion of sales became dubious and as price declines seemed in the offing.

Industrial production reached a postwar peak of 195 (percent of the 1935-39 average seasonally adjusted) in October 1948, and was still above 190 in January 1949. Operating plans of industrial managers then began

to show the effect of the unplanned accumulation of inventories in the plants of manufacturers. Production was cut back, moderately in February and then much more rapidly. It became increasingly clear that a definite break in the inflationary movement had developed, and that the change was not merely a hesitation in the course of expanding business such as had occurred in the first quarter of the preceding year. In each of four successive months, beginning with March 1949, the industrial production index dropped 5 points. In July, partly due to vacations, the decline was 8 points, carrying the index down to 161. The drop of 34 points from November 1948 to July 1949 was more than 17 percent, wiping out the entire increase in the index of industrial production since the spring of 1946.

The effect of the decline in industrial production was augmented because the relationship of prices to the income structure, and some anticipation of price declines, had led even earlier to a pronounced shift in private construction. The record level of new housing starts in the first half of 1948 maintained expenditures during the second half well above those of the same period in the preceding year. But the trend was reversing. In 1947, the number of housing starts climbed each month until a peak was reached in October, and expenditures for private construction increased each month from May until November. After May 1948, there was a continuous decline in the number of new housing starts. Expenditures for private construction fell slowly but constantly after August.

Nonagricultural employment, which was 1.3 million higher in December 1948 than the average for the first half of that year, declined 1.9 million from December 1948 to February 1949, while the labor force declined only 1 million. There was also a seasonal decline in agricultural employment, so that unemployment increased in the two months from 1.9 million to 3.2 million. The subsequent seasonal increase in agricultural employment in the spring was not large enough to offset the growth in the labor force and the further moderate decline in nonagricultural employment. In June 1949, there were 3.8 million unemployed, and in July the number mounted to 4.1 million.

The importance of the changes in inventories during the period under consideration has caused many to refer to the business recession of 1949 as an "inventory recession." It is true that much of the decline which took place could be traced to and connected with this sector of the economy. It is also true that, when inventories had fallen considerably below the requirements of the current level of business activity, a process of inventory rebuilding attended the upturn. But it is characteristic for inventory changes to appear early in recessions. The extent to which the general decline proceeds is determined by how far "inventory adjustments" are accompanied and followed by more fundamental drops in industrial production, employment, prices, capital investment, and national income. These more fundamental factors dropped only slightly in the 1949 recession.

To say that they did not drop further because it was merely an "inventory recession" confuses a description of what happened with an explanation of events. An important reason why the decline did not go further was that there were new factors in the business structure and in the programs and policies of Government. It is debatable whether these new factors and programs would have been sufficient under different circumstances; but they were sufficient under the conditions of 1949.

The process of recovery: since mid-1949

The recessionary movement had become formidable during May and June of 1949. This confronted the Council of Economic Advisers with the difficult task of advising whether or not drastic measures should be proposed in connection with the Midyear Economic Report of the President. In its own Midyear Economic Review, the Council said that industrial production would drop and unemployment would rise further in July. The previous record of business cycles offered much evidence that revival would not set in prior to a sharp drop in industrial prices, and in June these prices had fallen less than 6 percent from their inflationary peak. Nonetheless, the Council, upon analysis of the whole situation, felt that drastic measures were not needed. We felt that the recessionary movement was even then being brought to a halt.

Manufacturers had not been content to cut back production enough to balance it against new orders. They had reduced operations sufficiently to permit a reduction in their inventories each month, even while consumer buying continued at high levels. By midyear it seemed clear that the fundamental factors of demand were strong enough to stimulate a rapid increase in industrial output.

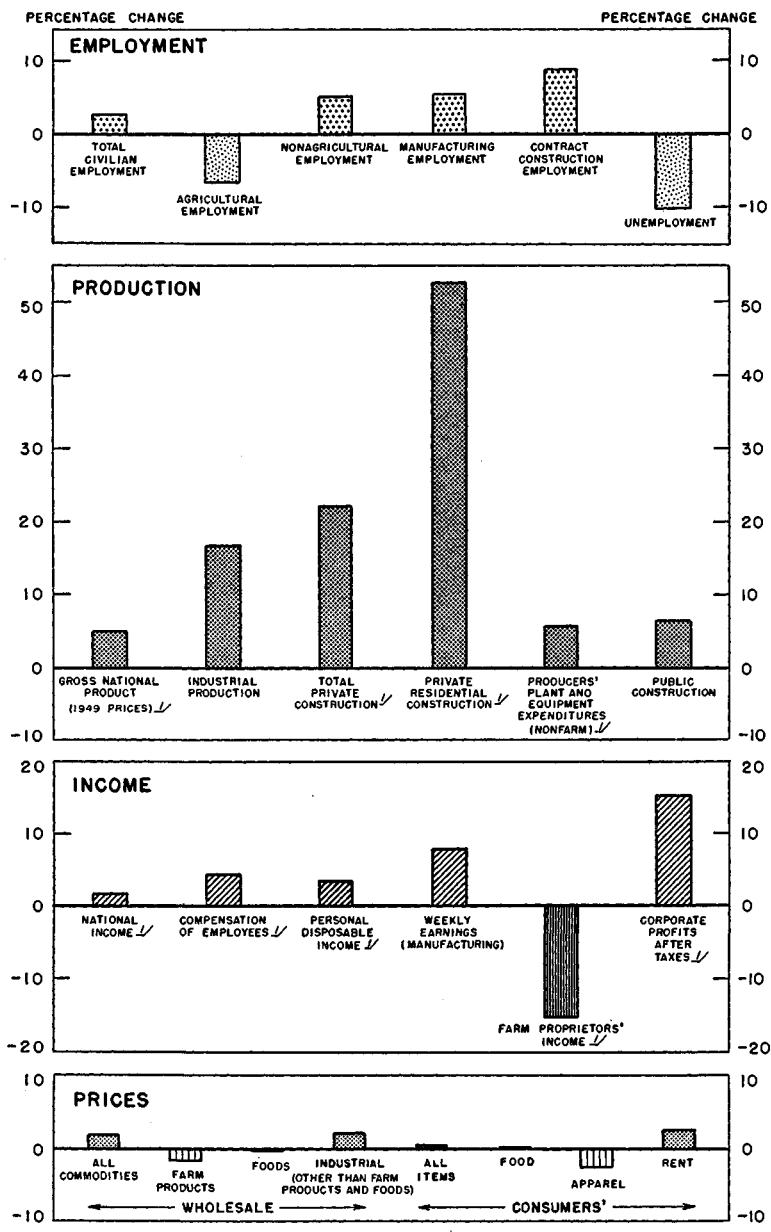
The optimism of the Council at that time rested upon analysis of a postwar economy differing considerably from any in which the characteristics and events of business cycles had been previously studied. The war years had lifted national income and personal income far above old levels; moved employment into a range which was called fantastic when first prophesied; established vast funds of liquid savings in the hands of consumers and businessmen; created an enormous public debt; and left problems of national security, of obligations to veterans, and of aid to foreign nations which multiplied the peacetime expenditures of Government. Added to these factors, there was a wide range of anti-deflationary programs which the Government had established following the catastrophic deflation of 1929-33. It was felt that this combination of forces would quickly activate a strong recovery, if supplemented by business confidence and some further moderate adjustments in business policy.

Thus it was that the Council's emphasis in midyear 1949 converged upon the factor of business confidence. New capital investment in building construction and in producers' equipment had always been extremely volatile, because plans for investment are largely determined by expectations with respect to future markets and future profits. Plans can change

CHART 4

ECONOMIC INDICATORS

CHANGES FROM A YEAR AGO



quickly when expectations change. Pessimism in the business world can go far toward vindicating itself, by inducing a contraction in new investment which forces the business slump which is feared. Optimism in the face of declining business, if it leads to continuance of new investment at a high level, may permit a market adjustment to be worked out while the basic economic factors of consumer income and buying power are but little impaired. Such optimism may thereby justify itself.

Considerable optimism when business activity is declining has not been unusual at the beginning of a recession. Emphatic assurances that a break in a business boom could not become a depression, because fundamental factors in the economy were strong, have often been given by national leaders and by business experts. But seldom, if ever, before 1949 has that business optimism which demonstrates itself in sustained new long-term investment survived a decline in industrial production as great as that which took place in the first half of 1949.

While business investment was indeed retarded during the recession, the degree of confidence and strength manifested throughout the first half of 1949 was encouraging. Private construction expenditures during this period were at a seasonally adjusted annual rate of 17.0 billion dollars, compared with 17.4 billion in the first half of 1948 and 12.2 billion in the first half of 1947. The usual seasonal pattern was followed, and in each month after the low in February there was an increase in construction expenditures. This was also true of residential construction, which accounted for about one-half of the new construction. Even more remarkable was the high expenditure, though at a reduced rate, for new plant and equipment. This meant further extension of productive capacity following three years of almost feverish activity for that purpose. These business expenditures in the first half of 1949 had exceeded those for the same period in 1948. This led the Council of Economic Advisers to conclude that business optimism would survive the further slackening of industrial activity in July, and would permit the seasonal elements of economic expansion in the late summer to act upon an economy which had not suffered further deterioration.

The reaction to price adjustments was also reassuring. Business in the main did not take these adjustments as a bad omen, but instead recognized that they were laying the foundation for a resumption of economic growth. Price declines are always to a degree depressing, because they cause losses on current stocks and hesitancy about future buying. One of the most delicate of all economic operations is to achieve price reductions sufficient to reactivate buying, without letting price deflation go far enough to undermine morale, disorganize business relationships, and generate a panic. That this delicate operation was so effectively consummated during 1948 and 1949, through myriads of business decisions, was a heartening demonstration of the application of improved economic knowledge to the practical realities of business life.

Most important of all, the recession of prices and some cutting down of business plans did not generate a general decline in the incomes of the great body of the buying public. It is when prices and incomes chase each other downward that the spiral of depression is irrevocably under way. Businessmen in 1949 made great efforts to hold lay-offs to a minimum, and wage cuts were rare. This helped to maintain purchasing power. Furthermore, the whole income structure was strong because of wide improvements in private and public policy, adopted over the years, including collective bargaining, minimum wage laws, and old age and unemployment benefits. There were also payments to veterans. Government expenditures, much greater than before the war, contributed to the maintenance of income and demand.

High income levels and large market demand on the part of consumers are the foundation of economic strength, and furnish an important impetus to business investment. This consumer strength, usually impaired but little in the first months of a business reversal, did not become enfeebled later on in 1949 by developments which in earlier periods had transformed an economic adjustment into a disaster. Personal income in the second quarter of 1949 was only 3 percent below that in the final quarter of 1948, and personal consumption expenditures had fallen by less than 1 percent.

Other programs also cushioned the shock. The farm price support program forestalled any collapse of agriculture, such as destroyed the market demand of farmers in 1920 and in the years after 1929. The regulation of security exchanges, and of the issue of securities, prevented the building up of a speculative structure as in the twenties. Monetary and credit policies, supplementing the sound banking structure of the Federal Reserve System, maintained abundant and cheap credit, protected debtors from the dangers attending maturing debt in periods of business stress, and prevented financial crises such as those which ushered in earlier depressions.

General fiscal policy was also an important factor toward inducing the recovery. When business declined, the tax system operated automatically to reduce revenues. Certain programs, such as unemployment insurance, increased payments to the public. These "built-in" stabilizing factors contributed to the budget deficit but they also contributed to business revival.

The recovery phase began in August 1949. The trend of several business indexes was not changed for a number of months, but the shift from contraction to expansion was indubitable. Industrial production rose rapidly, the index mounting from 161 in July to 170 in August. Employment in manufacturing increased by 350 thousand, or more than 2.5 percent. Unemployment, which had increased more than one million from April to July, declined 400 thousand. Expenditure for private construction continued its upward movement, and new housing starts, which had been maintained at the high level reached in May, began a new upward surge which in August almost reached and in September and October surpassed the highest pre-

ceding level in the postwar period. The sale of automobiles continued to expand.

The irregularity of business recovery after a recession was heightened by serious industrial disputes during the autumn and winter months. Unemployment shifted up and down, and in the three winter months grew 1.3 million to the disturbing level of 4.7 million. But the recovery movement was strong enough to rebound after each setback, and when the coal stoppage was concluded early in March 1950, progress became sustained and rapid. By June 1950, the industrial production index had climbed to 199, four points above the previous postwar peak, private construction had far surpassed earlier levels, nonagricultural employment was larger than in the same month in any preceding year, unemployment had dropped to 3.4 million, business profits were increasing, new investment by business was growing, and the real incomes of consumers were increasing. All this was before the Korean development.

WHAT WE HAVE LEARNED FROM THE RECORD

The first general conclusion which we can derive from the record of the past five years is this: our economy is far more resistant to shock than it was after World War I. It is better prepared to deal with inflationary or deflationary dangers. Those who point out the "exceptional" reasons for this overlook the fact that many of these "exceptional" items are just as integral a part of our economy today as the conditions which made for greater instability were an integral part of the economy of 30 years ago. For these new developments are not to be found simply in the larger magnitudes of the current economy. They reside in new patterns of business behavior and new programs of Government which have come successfully through hard tests.

There is need for further improvement, but we can build confidently upon what we have thus far achieved. This leaves little room either for those extremists who would pillory business or for those who would hamstring effective public policy. The interplay of private and public action in overcoming the dangers of reconversion, inflation, and recession indicate conclusively that this interplay will continue to be necessary. It calls for ever-increasing understanding and cooperation. The domestic situation makes this desirable; the world situation makes it imperative.

The second conclusion to be drawn from the record of the past five years is that the healthiest and safest condition for an economy such as ours is maximum utilization of our productive resources, although the types of output and use may shift with changing needs. During the inflation of 1948, there were some who said that a lower level of total activity would provide a cure for the dangers of inflation. But when we entered upon that lower level of fundamental activity, we felt even more insecure and yearned for the day when full production might be restored. It became abundantly apparent that this lowered level of activity did not add to the confidence of

business, the security of workers, or the ease of solution of public problems. On the contrary, it made business less sure of itself, labor more restive, and the problems of Government more difficult. The American economy must make maximum utilization of its resources in order to thrive and to fulfill its inescapable domestic and world responsibilities.

It follows from this, as a third conclusion to be drawn from the postwar period, that we must draw a sharp distinction between the sound elements of maximum production and the unsound elements which threaten its maintenance. Inflation, for example, threatens the maintenance of full production. But it is no solution to overcome inflation by private or public policies which turn the whole economy downward. For this not only carries us into an even more difficult situation, but also leaves us with the prospect of a restoration of inflationary trends as we shake off the recessionary threat and move vigorously upward again.

Despite the inflationary dangers which they may produce, programs essential to our national security or general economic strength must be undertaken. For example, we cannot now refrain from very large expansion of military and related efforts, although there is no practical way of undertaking this expansion without risking inflationary pressures.

This does not mean that inflation should be taken lightly. It erodes national strength by distorting the economy. The distribution of income and wealth is altered, impairing the position of persons and institutions receiving relatively fixed incomes and owning assets of fixed money value. Production is channeled into unsustainable patterns, thus sowing the seeds of depression. Public morale is shaken. Confidence in the financial future may be impaired with serious implications for later periods of inflationary pressure.

For this reason, we must seek by improved business practices and improved public policies to remove or contain the inflationary threats arising from necessary enlargement of essential national programs. If the expansion of these programs goes even beyond the amounts recently recommended for increased defense, which an expanding economy should be able to absorb with rigorous fiscal and credit policies and limited controls, it would then become necessary to consider even more drastic controls and even more substantial reductions of other programs.

The fourth conclusion to be drawn is that stability and economic strength are advanced by private and public policies which adjust themselves to our need and prospects for stable growth, instead of adjusting themselves to the inevitability of the business cycle. If business in 1949 had assumed that a postwar depression was inevitable, and had run for cover accordingly, the protective curtailment of investment and employment would have accentuated the downturn. Instead, while making some adjustments, business kept its eyes riveted upon our prospects for national growth, and the policies which it correspondingly adopted contributed mightily to the resumption of that growth. Similarly, if the Government had reacted to the recession by excessive retrenchment policies, these would have enlarged

the downturn. Instead, the pursuit by the Government of a range of national policies necessary to our economic health, and supportable by the resources of a full economy, helped greatly to reverse the recessionary trend and to restore the trend toward maximum business activity and employment. Confidence is no substitute for sound policy. But sound policy must rest upon confidence commensurate with our natural resources, our business equipment and skills, and our uniquely proficient working population.

That confidence and that long-range viewpoint are essential now, if we are to cope successfully with the problems raised by the Korean developments. These developments call for many changes in programs and in emphasis, but the principle still stands. The targets for needed levels of production and employment, required under the Employment Act of 1946, are not merely abstract aspirations. They can guide private and public economic policy along lines that will best serve our national needs.

Each of these conclusions has direct relevance to the current economic situation, and to the emerging difficulties presented by international developments.

II. The Problems Ahead

VERY recent events have placed international developments, and their impact upon the domestic economy, in the forefront of public attention. It is manifestly impossible to predict the future sequence of these developments. This makes it difficult to discern the appropriate economic policies which should now be followed. But the difficulty does not remove the necessity. The fact that our future programs may be largely influenced by the action of other nations does not force us to drift aimlessly. The need for maintaining the American economy at maximum strength and productivity has become even greater than before. In domestic economic affairs no less than in international, we must be prepared and watchful, retaining enough flexibility to change our course quickly as conditions change.

THE ECONOMIC IMPACT OF INTERNATIONAL DEVELOPMENTS

The economic outlook at midyear before the Korean development was highly favorable. Production and employment had attained a new peacetime record level for the month of June. Despite attainment by the economy of levels above 1948, when inflationary conditions had become dangerous and were soon to lead to a recession, there was no serious threat of inflation. Considering the pace of the business revival, price rises in general had been moderate; although certain markets, such as those for non-ferrous metals and building materials, were under pressure because demand crowded supply. In wide areas of the economy, some margin of unused productive capacity was still available. There had been very large new investment in productive plant and equipment, which increased capacity substantially above that of 1948. The labor force had grown more rapidly than employment, and, despite the high level of employment in June, there was a margin of between 1 and 2 million in the number of job seekers above a number which would represent a comfortable but not a tight labor situation. The prospect a month ago was that we could achieve maximum production and employment without inflation by the end of the year. This would have completed the business recovery, and would have placed us in good position for healthy growth in the years ahead commensurate with normal increases in the labor force and constant improvement of technology.

At midyear, however, there occurred the outbreak of hostilities in Korea, followed by the certainty that our military exertions and defense preparations will need to be increased greatly for a considerable period of time. We cannot yet judge the extent or duration of this new turn of events. If other nations were to force this country into defense programs comparable to those of war, a full war economy would then need to be established. If the Korean situation were to be followed by a situation of heightened and prolonged tension requiring that we be fully prepared for military effort at many points in the world, the resulting increase in expenditures would require even more extensive economic controls than those thus far proposed.

The current request for an additional 10 billion dollars for increasing our armed forces and our military outlays, while very sizable, does not involve full mobilization of our military might or the placement of our civilian economy on a full wartime footing. But the increasing preparations for defense which must now be made will have a very substantial effect upon the domestic economy, even though not all of the additional appropriations will be expended this year. The stepping up of military procurement will cause further tightening of the market situation in important areas of the economy. There has been and will be some increased forward buying, both by business and by consumers. There will be a larger demand for labor, and a tendency toward wage increases of a magnitude which would increase the costs of production and add to the pressure on prices.

Such increased pressures, superimposed upon an active economy, could quickly create a sufficiently serious inflationary situation to require the whole gamut of comprehensive and direct controls, if advance buying by business and consumers should approach the proportions of hoarding or rampant speculation, or if prices and wages should commence to spiral. This would also follow if further changes in the international situation should require the stepping up of military efforts and procurement even more rapidly than has thus far been proposed. But if neither of these contingencies develops, price, wage, and manpower controls should be avoidable. There is some margin of unused capacity in most industries, even apart from the use of double shifts and overtime work, and there is still a substantial reserve in the labor force. The utilization of these reserves, plus some necessary capacity expansion, should cover military needs on the present scale without a complete set of controls, if production is effectively channeled into essential areas through material allocation, and, above all, if total demand is held in check by strong tax and credit measures.

Output per man-hour was estimated to be about 11 percent above the 1945 level in the first half of the year. This means an average gain of about 2.4 percent per year (compounded), slightly higher than the average rate in the prewar decade. With vast recent improvements in plant, technology, and skills, we should certainly be able to maintain at least the recent rate of increase in output per man-hour over the next few years.

Coupled with this productivity trend, there is the certainty of a growing labor force. The labor force, in fact, is likely to increase more rapidly than is indicated by the size of the normal annual increment, because many new workers are drawn into industry when the economy is working at high speed. Additional labor power is also available in the current body of 3.4 million unemployed workers, and among those who now work only part-time. While substantial numbers of men will be drawn into the armed forces, it seems clear that the labor force will be large enough to permit sizable increases in civilian employment.

Without an unusual increase in the labor force, or in hours of work, maximum employment would involve by the end of 1950 an increase in our annual rate of total output of about 8 billion dollars at present prices. But our potential increase in production is considerably greater, allowing for the further reduction of unemployment by 1 to 2 million, for possible enlargement of the labor force, for the possibility of full-time employment of many who are now employed only part-time, and for the full use of existing plant capacities. In succeeding years, we can expand about 3 percent annually.

With this output potential, the economy is in good shape to deal with increased programs of substantial scope. Nor does the fact that there is so much less slack in the economy than there was in 1939 mean that we are faced with unmanageable problems. It is true that additional procurement programs, coming in a period of boom, create greater problems of scarcity and inflationary pressures. But these problems can be dealt with more expeditiously than the time-consuming process of shifting an economy from low gear into high.

Now that we are in high gear, however, we must exert every effort to produce even more. Our economy is so flexible, and its demands so varied, that the increase of total production up to the limits of our resources will be the most effective general effort that we can make. The more we produce, the more fully we can supply the most essential purposes without diversions which would impair other sectors of the economy.

But the increase of total production will not in itself be enough. The kind of situation in which we now find ourselves, and the immediate outlook, will impose concentrated strains upon some lines of supply much greater than the average strains upon the economy as a whole. The increased need for steel, and other items entering into military and related uses, will be relatively much greater than the increased demands upon the economy as a whole. And the increased need for these special products will converge largely upon areas where supply is already tight, and the utilization of existing capacity complete or almost complete. This means that the expansion of production in these specific lines must take precedence over the expansion of other lines. This involves special problems of labor utilization as well as use of facilities and materials. It also means that, in special lines, expansion of total output probably cannot proceed rapidly

enough to avoid the necessity of some diversion from less essential use to the most essential use. It follows that policies directed toward the expansion of specific lines, and toward influencing the composition of the demand for and the distribution of these products, are likely to become just as urgent as policies to reduce the total level of demand to counteract general inflation. Both types of policies are now needed. This must be taken into account, as we turn to a consideration of the private action and public policy called for by the existing situation.

THE TASKS OF PRIVATE ADJUSTMENT

The business policies which have carried us through almost a year of production increases should, with some adaptation, be helpful in the treatment of the problems lying immediately ahead.

Since early 1949, the Council has urged that businessmen expand plant capacity and investment to meet the constantly expanding requirements of an economy operating at maximum production and employment. The extent to which this course has been pursued, even under the threat of the 1949 recession, contributed greatly to the speed and durability of the advance in output and employment. In many of the important sectors of the economy, the recent upward revision of business investment intentions should not be reversed because of current developments. In some outstanding areas, indeed, further expansion has become a more crucial need.

There need be no fear that this enlarged productive capacity would become unusable if and when international tensions subside. With enlarged capacity available, the great and growing domestic market for goods and services of all kinds should never reach the end of the road. We are now too far from the termination of World War II to talk about postwar backlogs which will eventually be worked down, except in a few areas. A very high and growing level of current demand should be regarded as a permanent feature of a 270-billion-dollar economy, able to move forward at the rate of 9 to 10 billion dollars a year.

There are many illustrations of the fact that a level of demand which was regarded by many as "abnormal" in 1948 was below the level which should be regarded as normal and necessary for 1950 and in the years ahead. Such is the dynamic quality of our economy. Some thought that the Nation's steel production was above a sustainable level two years ago. Since then, however, the industry has substantially enlarged its capacity and is planning further enlargement. But even before the international events of last month, the industry had been straining capacity, despite incomplete recovery of the Nation from a business recession. Thus, the further expansion of the steel industry would be good business even in an entirely peacetime context. The only effect of the present international situation is to make that expansion more urgent. To assume that this accelerated expansion should not be undertaken, because it might exceed the need if international tensions should subside, would neglect the vital need of

today. It would be unrealistic when measured by the standards of desirable and attainable peacetime growth for the economy as a whole.

There are other situations where capacity has lagged behind the requirements of an expanding economy. Iron ore as well as nonferrous metals are examples. The increased demand, which will be injected into the economy by enlarged defense expenditures, will be superimposed upon a great civilian demand. If this increased demand imposes an excessive strain upon supply in important areas, the most lasting solution will be for the supply to be increased. Business policy should take this into account. Some situations will occur, however, where the alternative of reducing demand will be the only immediate solution.

The problem of pricing policy is accentuated by recent developments. In most of the areas where prices have been rising, further increases are not needed to provide the incentives for enlarging supply, because profit rewards are now adequate. Restraint and moderation in pricing policy are vitally significant at this time, when international uncertainties have already led to unwarranted price and inventory developments in some areas. Many of these areas are more or less subject to conscious price policy, and businessmen have an opportunity to serve their country as well as themselves by extreme caution in pricing.

Another area in which business needs to exercise judgment and foresight is in the management of inventories. These in the main have been skillfully handled since the war. The accumulation of inventories, since the beginning of the recovery movement, has perhaps not been excessive in view of the depletion which previously occurred. But enormous damage could be done if businessmen now engaged in a speculative race for goods to avoid a feared shortage later on. If inventories are carefully managed, a shortage later on should not occur, for reasons which have already been advanced. But panicky action could produce an artificial shortage, disorganize the markets, cause substantial business losses in a speculative race, and increase the pressure for more legislative curbs. It could also seriously impair essential Government programs.

It is also important that banks adjust their lending operations to the new military and economic situation. This will require selectivity of loan policy, so that bank credit will be available for business expansion which is needed for industrial mobilization, while bank credit for speculative uses and for nonessential purposes which compete with military programs for manpower and materials must be sharply restricted.

Wage policy is inseparably connected with price policy. The Council of Economic Advisers, in January, committed itself to the desirability of a wage-price policy which sought to stabilize prices and to gear wage increases to general advances in productivity. This policy, which of course requires variations to cover differing individual situations, has recently been endorsed by important business organizations. It has been incor-

porated in the five-year contract of one of our largest industrial concerns and the union which represents its employees.

The possibility that strong and general inflationary impulses may develop within the economy calls for great moderation in the area of wages as well as prices. It is less important now to speculate whether wages chase prices or vice versa, than it is to make sure that neither commences to chase the other. In considering wage policy, it should be remembered that the only production which is available for civilian consumption is civilian production. To the extent that increased production is channeled into military purposes, it cannot be translated into civilian enjoyments. Labor also has an interest in helping the effort to train and channel workers into the most necessary jobs. The more extensively this is done on a voluntary basis, the more feasible it will be to avoid manpower controls.

The opportunity is now afforded to consumers as such to make an affirmative contribution toward economic stability. The safest rule for consumers, in their personal interests as well as that of the Nation, is to follow their normal buying habits. A wild scramble to purchase durables, or to build up an inordinate reserve supply of soft goods, could turn a manageable economic situation into one of utmost gravity. The avoidance of this should be urged through every channel of popular communication.

Those who operate as producers and consumers throughout the vast and varied American economy are confronted with a responsibility somewhat different in degree, but essentially the same in principle, as that which they have met during the postwar years. It is the need for economic understanding, mutual accommodation, and concern for the national well-being. There is no escape from the fact that in the final analysis the cost of national security must be borne by the people. The record throughout the trials of reconversion, inflation, and recession indicates that the American public can meet their new problems with equal or even greater success.

THE RANGE OF PUBLIC POLICY

Public policy cannot be adjusted simultaneously to each of the possible contingencies of the future, particularly when so many of these are beyond the control of this Nation. An effort to do this would impair the effectiveness of current action directed to current problems. The degree of effectiveness demonstrated, in adjusting what we do now to what is needed now, will be the surest token that we can adjust later to whatever may be needed later on. The uncertainties of the future should not generate either paralysis or excessive action in the present.

We must maintain our domestic economy in a position to serve as a tower of strength for all the efforts of the Nation, not only during an emergency of a few weeks or months, but for years which may be many in number. The north Korean attack is a warning to the world to be prepared against the possibility of similar aggression at other points. The United States must be ready to bear its share of the burden of the common

defense. The heavier defense expenditures, which we are now undertaking, will not end when the mandate of the United Nations has been enforced in Korea. We are striving to avoid a major war, but there may be other alarms and possibly other attacks, and we must be prepared to meet them no matter how long may be the period before full peace is established.

Economic policy must now be adjusted to the prospect of this long pull. If the pull proves to be short, we shall lose little by being prepared; if it proves to be long, we shall gain much. Our efforts now should be directed toward developing and maintaining maximum national economic power indefinitely.

This statement of basic principles prompts three broad conclusions regarding public policy in the light of the current situation:

First, these policies should be designed to bring about a quick increase in production. Such an increase is essential not only to supply our military requirements, but also to meet the essential needs of our growing population.

Second, public policies should ensure that defense requirements and essential civilian needs have priority over other uses. Hoarding must not be tolerated, nor can we allow needed scarce materials to be used for nonessential purposes.

Third, public policies should provide protection against the threat of a new inflation. An increase of 10 billion dollars in military appropriations, coming at a time when our economy is already operating at near-maximum levels, will greatly increase demand for goods and for labor, thus putting pressure on our price and wage structure. A sharp and continued rise in prices and wages at this time would not only impose hardships on domestic consumers; it would weaken our whole economy and would impede our military effort.

In considering the economic effects of the proposed increases in defense expenditures in the setting of the current economy, we find firm ground for believing that it will be possible to make and maintain substantial enlargements in these expenditures without resorting to all of the controls of a war economy. But we must take some important steps now.

The first and most important of these is to use fiscal and credit policies to the fullest extent feasible for the restraint of inflationary pressures. On the fiscal side, this means that we should seek to reduce the size of the cash deficit substantially or, better still, to remove it entirely. For the maintenance of a large deficit creates and aggravates inflationary pressures in a time like this. The economy is strong enough to bear the burden of financing the needs which have now been outlined, without deficit financing and extensive increases in the money supply.

Before the north Korean attack, the domestic economy was moving into a range of national income which would have substantially enlarged budget receipts. The acceleration of economic activity, resulting from the expansion of defense preparation, is hurrying the enlargement of production and employment and accordingly the growth of tax revenues. The

imperative need now is to provide additional sources of revenue, to cover the new defense and related expenditures as rapidly as possible. Such a program will help to curb inflationary forces (a) by restricting the enlargement of the money supply, and (b) by reducing the buying power of consumers and business.

In our judgment, the economy is now strong enough to bear the burden of substantial increases in tax rates in accord with this principle and to do this without endangering the maintenance of maximum production. There are, of course, alternative sources from which this amount of revenue could be obtained, but we cannot urge too strongly that some combination of methods should be applied immediately toward this end. The program of other restraints, now being recommended, will prove woefully inadequate without a prompt and drastic increase in taxes.

The fiscal policies we have recommended would not sufficiently eliminate the inflationary threat. There would be delay in the increase of Federal tax collections, and in the meantime Government spending would considerably exceed Treasury receipts. There is also the danger that consumers and businessmen may engage in panicky buying.

Further restraint upon civilian demand for goods should now be imposed through the control of consumer credit, and through the tightening of credit for building construction. Administrative measures have been taken to tighten terms on residential loans insured, guaranteed, or made by the Government. Further legislation is needed to tighten both private and governmental lending policies. In addition, further controls should be established over commodity speculation.

In addition to fiscal and credit policy, it is important to recognize that pressures in specific areas will far exceed the pressures upon the economy generally. Shortages already exist with respect to some of the essential elements of a military program. The prices of some of these commodities have risen much more rapidly than average prices during the first half of this year, and some price increases have been accelerated in recent weeks. This requires a compulsory allocation program, not only to assure adequate military supply, but also to prevent price and cost increases in these limited areas from spreading outward through the whole economy. It will not be enough, in this connection, to establish a program which enables the military to procure promptly the materials which it needs. This alone would only aggravate competitive bidding by other users. The inevitable rise in prices would move into the costs of production of most producers of goods and services. The program should therefore provide for limitation of nonessential use. This would reduce the total demand to match the supply. There should also be the power to requisition hoarded or unnecessary supplies of these essential commodities, and to prevent excessive inventory accumulation.

Careful analysis of available material requirements for the expanding defense effort indicates that some specific measures should now be taken to expand capacity and accelerate production, as a supplement to allocation. We cannot afford to be caught short of essential supplies. The experience during World War II developed a number of useful methods, such as loans, guarantees, and purchase contracts, to expand capacity, finance essential production, and speed technological development.

We do not recommend the employment of general controls over prices and wages at this time. The productive potential of the nation has risen well above the level of two years ago. Business and labor have both had a bitter though brief taste of the consequences of inflation, and should profit by their added experiences as to how to ward it off. But the recent up-surge of prices and advanced buying indicates how quickly we can pass over into a dangerously inflationary situation. These tendencies, if not promptly checked, are sure to generate additional wage demands. The speed with which they can be checked depends not only upon private restraint, but also upon much higher taxes, vigorous restraint upon credit, and a strong allocations program. These measures, in our judgment, should be undertaken at once. At the same time, the appropriate agencies of Government should continue and intensify their development of plans for the utilization of more sweeping controls over the price-wage structure and over the utilization of manpower. These efforts should be brought at once to so high a stage of development that, if the need becomes clear, a request to and action by the Congress would enable their immediate application.

Other Government programs may here be mentioned briefly. Future developments beyond the control of this Nation might make it necessary to pare down or defer some of these domestic programs even more than is now being done. But we should bear in mind that some of these programs are affirmative reinforcements of our economic stability and growth, and consequently of our military potential. The economic significance of these programs has been depicted fully in previous reviews. It need not be reiterated in detail in this review which concentrates upon the significance of recent changes in the domestic and international situation.

One problem which does deserve renewed emphasis is that of dealing with such unemployment as may occur despite our best efforts to avoid it. Even with unemployment further reduced, those who are unemployed should not be left without the adequate protection that our Nation can so well afford. The first line of defense against hardships caused by unemployment is unemployment insurance. The test of 1949 revealed clearly that the Nation-wide system was deficient, whether measured by extent of coverage or duration and size of benefits. Action is needed this year to improve the Federal-State unemployment insurance system along the lines recommended by the President. Without such action, many of the State

legislatures will probably not act in 1951, and considerable delay would then result in achieving these necessary improvements.

The Council of Economic Advisers has confined its proposals at this mid-year to a relatively short list. We are mindful of the crowding of the congressional calendar with transcendently important issues of international policy. We have therefore thought it best at this stage to identify only those matters which appear to us to be of greatest urgency in the current situation. Our views on a broader range of programs, inseparably connected with the stability and growth of the American economy, have frequently been stated.

III. Economic Developments in the First Half of 1950

THE COURSE OF EMPLOYMENT AND PRODUCTION

THE FIRST HALF of 1950 brought large gains in employment and production. These gains have moved us much closer to maximum levels. But at midyear the development in Korea indicated the need for further increases in output.

Employment

In June of this year, almost 61.5 million persons held civilian jobs, a new record for June.

The contrast with a year ago is impressive. From June 1949 to June 1950, the civilian labor force increased by almost 1.5 million, while unemployment decreased by about 400 thousand. Nonagricultural employment expanded by 2.5 million. Agricultural employment declined by 650 thousand. Total civilian jobs increased by 1.9 million. (See chart 5.)

The developments from May to June were significant. There was a net addition of more than 2 million persons to the labor force. Unemployment, however, increased by only slightly more than 300 thousand. Almost a million more persons found jobs in agriculture and about 800 thousand more found work in nonagricultural lines.

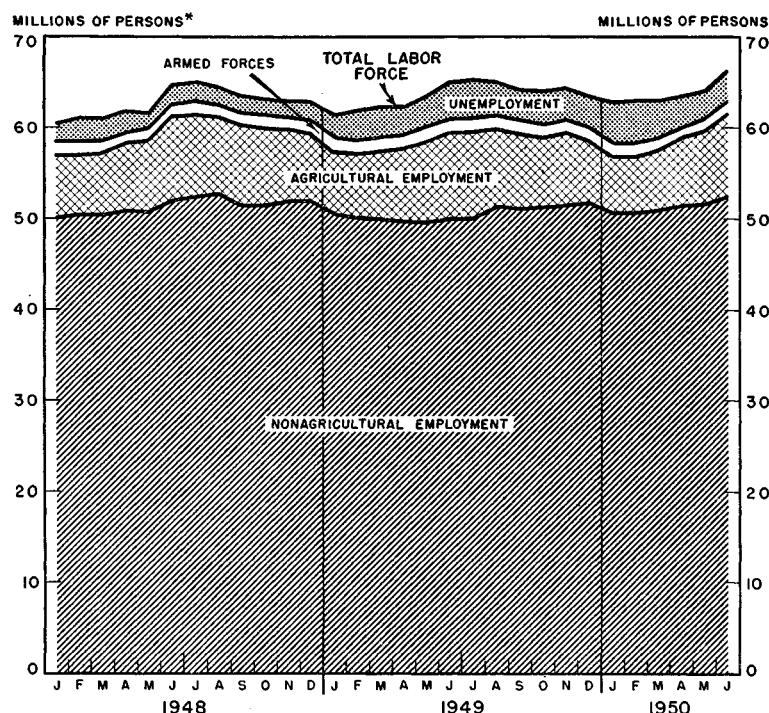
Agricultural employment of 7.2 million in the first half of 1950 was considerably below the same period of the years immediately preceding. It was 700 thousand below the first half of 1949 and 300 thousand below the first half of 1948. In contrast, there has been a notable upward trend in nonagricultural employment. The average of 51.3 million for the first half of 1950 indicates a gain of 1.2 million over the first half of 1949, and a gain of 600 thousand over the first half of 1948. The increase in nonagricultural employment during the first half of 1950 has been steady since February, with the improvement from May to June being particularly noteworthy. (See appendix table B-9.)

Between January and June of this year, total manufacturing employment increased by about 650 thousand, to 14.6 million, with almost all of the increase taking place in durable goods industries. Moderate increases occurred in contract construction, which rose to 2.4 million in June, and in transportation, trade, and service. Changes from May to June of 1950

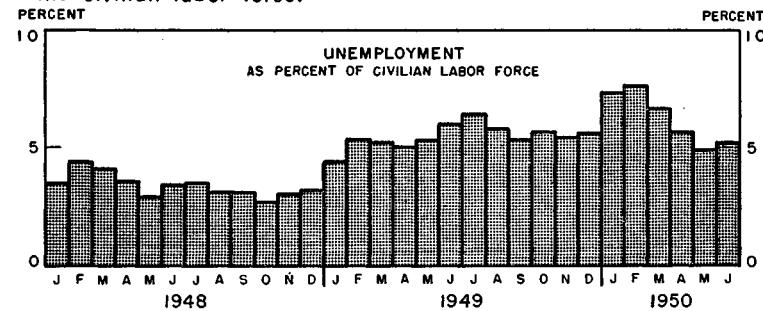
CHART 5

LABOR FORCE

Civilian employment reached an all-time June high of 61.5 million in June 1950. Nonagricultural employment was 2.5 million higher than in June 1949, while agricultural employment was 650 thousand lower.



Unemployment reached, in February 1950, a postwar peak of 4.7 million or 7.6 percent of the civilian labor force. By June, it was reduced to 3.4 million, or 5.2 percent of the civilian labor force.



*14 YEARS OF AGE AND OVER.

SOURCE: DEPARTMENT OF COMMERCE.

indicate that durable goods manufacturing and construction showed the most important increases in employment. (See appendix table B-10.)

Unemployment

The favorable upward trend in employment has been accompanied by a favorable downward trend in unemployment. After reaching a postwar peak of almost 4.7 million in February of this year, unemployment dropped by about half a million in each of the three succeeding months to a level of about 3.1 million in May. In June, it rose to 3.4 million, but this increase was less than seasonal. Unemployment now represents about 5.2 percent of the civilian labor force, compared with 6.0 percent a year ago, and with a postwar high of about 7.6 percent in February of this year. (See appendix table B-9.)

Currently in the United States (including Hawaii), there are 9 major labor market areas and 22 smaller labor market areas where unemployment is 12 percent or more of the labor force. This is a decided improvement over April. In 13 of these areas, there is no indication of long-standing distress and there is reason to believe that continued improvement in national economic conditions will reduce the burden of unemployment. In the 18 other areas, the problem of unemployment seems more chronic in character.

The incidence of unemployment has been relatively more severe during recent months for semiskilled workers and unskilled nonfarm laborers. The highest rates have been as usual among workers under 25 years of age, both male and female. Much of the unemployment in this younger group results from frequent job changes as they are getting oriented in the labor force.

In June of this year the unemployment total of 3.4 million included slightly under a million persons who had been unemployed and looking for work unsuccessfully for 15 weeks or longer. This number, which had been increasing steadily since the beginning of 1949, started dropping somewhat in May and June of this year. There was a slight reduction in June, for the first time this year, in the number of persons unemployed six months or longer (estimated currently at 450 thousand). The duration of unemployment for those 65 years and over is about double that for teenage youth.

Early in 1950 a large number of workers were exhausting their claims for unemployment compensation benefits prior to finding another job. During the first quarter of 1950, this happened to about 730 thousand persons, the highest number for any quarter since 1940. There has also been a sharp increase in the average monthly number of general assistance cases reported by the Social Security Administration, from 462 thousand for the first quarter of 1949 to 628 thousand for the first quarter of 1950. The increase would have been even greater, except that many unemployed persons cannot qualify for public assistance because of the rigid means tests applied in many States.

There are slightly over a million persons who consider themselves full-time workers, but who are working on limited schedules because of slack work, materials shortages, and similar economic reasons. Most of these workers have the equivalent of a 3- or 4-day workweek. This is about one-half million below a year ago. In addition, there are about 1 million persons who regularly work part time, but who would prefer and could accept full-time work if such jobs were available.

Production

The value of all goods and services produced in the second quarter of 1950 is estimated at a seasonally adjusted annual rate of 268 billion dollars. This is 5.6 percent higher than in the fourth quarter of 1949, and slightly above the peak reached in the fourth quarter of 1948. (See appendix table B-1.) Moreover, with prices below 1948, the real output of the economy is now at a new record—about 3 percent above the fourth quarter of 1948. Even with normal conditions, we would need an increase of about 3 percent by the end of the year. The present international situation calls for a substantially greater increase.

Industrial production. The index of industrial production in June rose to a new postwar high of 199 percent of the 1935-39 average. (See chart 6.) This represented a gain of 18 percent over June 1949, and 11 percent over December. It exceeded by 2 percent the previous postwar peak of 195 reached in October-November 1948.

The recovery in durable manufactures has been especially marked, the June output being 16 percent above December 1949, and about 2 percent above the previous peak of October 1948. The most important changes in output since the 1949 lows are summarized in table 1. (For further details, see appendix table B-15.)

TABLE 1.—*Changes in industrial production since 1949 lows*

Item	Low period of 1949	Index, 1935-39=100 ¹		Percent increase from 1949 low to June 1950
		1949 low	June 1950	
Industrial production: total.....	June-July ²	165	199	21
Manufactures: total.....	June-July ²	172	207	20
Durable goods.....	October ³	175	236	35
Nondurable goods.....	June-July ²	158	183	16
Minerals.....	October ³	112	151	35

¹ Adjusted for seasonal variation.

² The effects of plant-wide vacations in July, mainly in nondurable lines, are currently only partly allowed for in the seasonally adjusted index. In order not to overemphasize the usual July dip, the average for June and July is used.

³ Production was reduced by work stoppages in October.

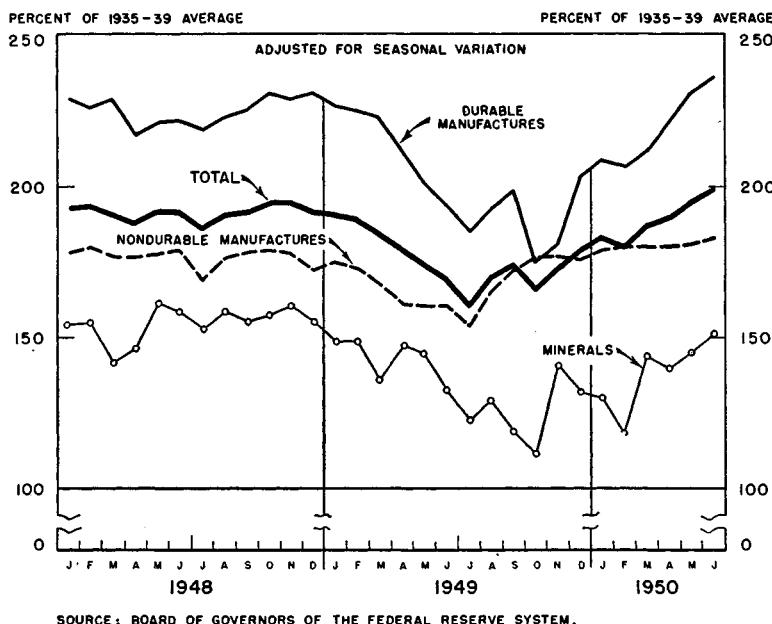
Source: Board of Governors of the Federal Reserve System (see appendix table B-15).

Private surveys suggest that industrial capacity has been expanding at the rate of at least 3 percent a year, while industrial output has barely surpassed the peak reached nearly two years ago. On this basis, present

CHART 6

INDUSTRIAL PRODUCTION

Industrial production in June reached a new postwar high, 2 percent above the previous peak in October-November 1948 and 18 percent above the level of June 1949.



SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

capacity could without undue strain turn out something like 5 percent more, which would raise the index of industrial production to about 210. In the present emergency, industrial output could doubtless be raised more than this by overtime work and by using extra shifts. In some individual industries, there is a considerable margin for expanding output; in others, little if any slack exists at present production rates. Larger capacity is needed, not only to meet the current defense needs, but to provide for the growing peacetime requirements of our expanding economy.

The changes in output have varied markedly from industry to industry, due to a variety of causes. Work stoppages early in 1950 were largely responsible for a drop of 3 points in the index of total industrial output. Immediately after the settlement of the coal strike, there was a sharp increase in the output of most durable goods. Since April, the steel industry has been operating at or slightly above rated capacity, which is more than 3 percent above last year. Output of steel in May and June set new all-time records.

Automobile production continued to increase in the first half of 1950, and has been one of the major factors of strength in the economic situation.

In spite of a prolonged work stoppage in the Chrysler plants, output in the first half of this year was more than 20 percent higher than in the first half of 1949.

Electric power production has shown steady expansion during the post-war period. The output of electric power in June of this year was about 12 percent greater than in June 1949.

Private construction outlays in June 1950 were 25 percent above June 1949, and public construction increased 6 percent in the same interval. (See appendix table B-16.) The boom in construction has been a key factor in the recovery since mid-1949.

Agricultural production. Present indications are that total farm production for sale and for farm home use in 1950 will be about 2 percent below the 1949 levels. The July crop reports indicate a lower output of several major crops, due partly to smaller acreages under the Federal allotments, and partly to the fact that prospective crop yields are not up to last year's high levels. In general, the reductions that are now in sight apply to those crops which are in surplus, especially cotton and grains. Food output is expected to be slightly larger than last year. The production of livestock and livestock products is increasing, and further increases are expected in the second half of the year. The supplies of all foods and feeds are fully adequate to meet our needs for the coming year.

Relation between production and employment

During recent years, there has been a gradual reduction in the number of workers employed in agriculture without a corresponding decrease in farm output. (See appendix tables B-9 and B-14.) Year to year changes in farm production per worker are greatly affected by weather. But there is little doubt that productivity per worker has increased since prewar days. It is estimated that output per farm worker averaged 43 percent higher during the period 1945-49 than during the period 1935-39. We should expect some further increase in agricultural output per man, and possibly some further declines in agricultural employment levels.

Increases in labor productivity are now being widely reported. The amount of the over-all increase cannot yet be statistically computed on a satisfactory basis. Nevertheless, it seems certain that a net increase in productivity is occurring. The limited data that are available suggest that output per man-hour in manufacturing may be increasing in line with the long-run trend commonly estimated at about 3 percent a year. In a majority of those industries where roughly comparable data are available, output since midsummer 1949 has increased more than employment or man-hours. This reinforces the conclusion that, with full utilization of manpower, the total output of the economy can grow considerably in the months ahead without serious strain, although there will be a tight situation in certain industries where plant capacity and the supply of raw materials are already under some pressure.

PRICES, WAGES, AND PROFITS

Prices

The rising tempo of business activity during the first half of 1950 exerted upward pressure on prices. The price increases prior to the Korean development were on the whole moderate. This is all the more significant since the economy within six months had moved rapidly from a condition with substantial slack to a level of activity close to conditions of maximum employment and production. Although the output of most industries during the first half of 1950 was adequate to meet current levels of demand, shortages reappeared for a number of basic commodities, particularly in some raw and semifinished materials, and resulted in some sharp price increases. The rapid expansion of business gave prices a generally strong tone but there was reasonable expectation that improvement in supply would take place, and that this would help to restrain prices.

Subsequent to the change in the international situation, there has been a broad upward surge in prices. The present pace of price increases largely reflect speculation and rumors about the impact of the stepped-up defense program upon supply as well as increased buying by business and consumers. This has created an atmosphere conducive to price increases.

Wholesale prices. Wholesale prices rose 4.0 percent from December 1949 to June 1950. The June level was 1.8 percent higher than a year earlier, but was 7.4 percent below the postwar peak. The largest advances were in wholesale farm and food prices. Industrial prices moved upward more moderately. However, in the four weeks since Korea the BLS daily spot price index of 28 commodities has risen 10 percent. The more comprehensive weekly BLS index of wholesale prices has increased 3.7 percent during the same period, a rise almost as great as during the first six months of 1950. (See chart 7, table 2, and appendix table B-22.)

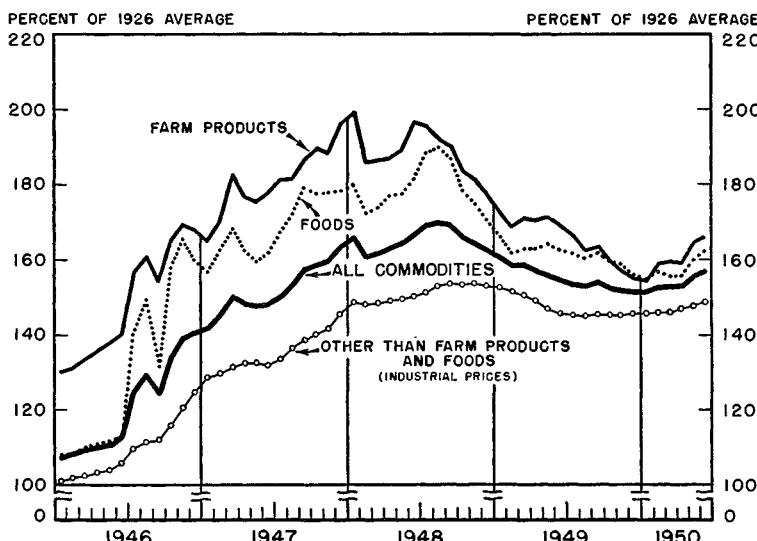
Wholesale farm prices rose 7.1 percent from December 1949 to June of this year, but were still 1.7 percent below a year earlier and 16.7 percent below their postwar peak. Although prices paid by farmers also rose during this period, the greater increase in prices received by farmers caused the parity ratio to rise moderately. In June the parity ratio was 97, compared with 95 in December 1949. The major rise in farm prices occurred during the second quarter of 1950, but particularly noteworthy was the fact that they rose also during the first quarter. There was no repetition of the sharp break in farm prices which had characterized the first quarters of 1948 and 1949. (See appendix table B-23.)

The rise in farm prices during the first half of the year was due to a combination of factors. Since most basic crops during the second half of 1949 were generally at or below support prices, this stimulated a heavy movement into the loan program, thus reducing the free supply and strengthening prices. The planned curtailment of 1950 acreage for the basic crops, and the sharp reduction in the prospective yield of winter wheat, caused some further upward pressure.

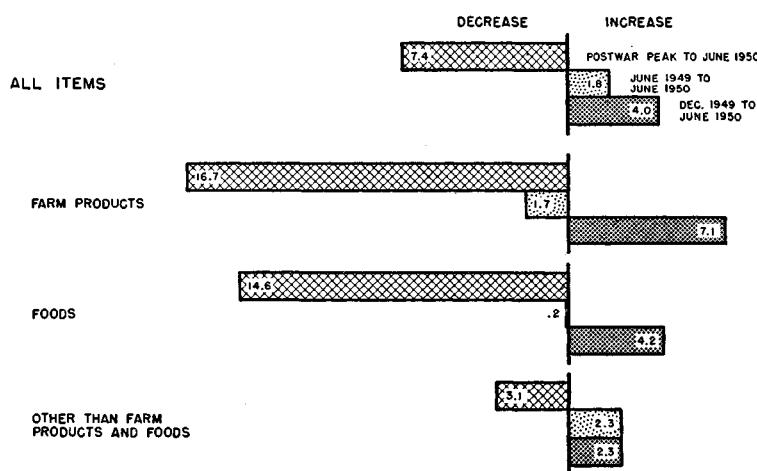
CHART 7

WHOLESALE PRICES

Wholesale prices moved upward during the first half of 1950. The overall rise in industrial prices was moderate, but there were sharp advances for some basic commodities. Farm and food prices rose more than industrial.



PERCENTAGE CHANGES



SOURCE: DEPARTMENT OF LABOR

The increase in incomes and employment in the first half of 1950 expanded the demand for farm products. This was particularly true of meat and livestock. The market for choice grades of beef cattle was strong. Hog prices were weak during the first quarter of 1950, but rose sharply during the second quarter. Not all farm commodities participated in the price rise. Large seasonal increases in supply held down the prices of dairy products, poultry, and eggs during the first six months of 1950.

Wholesale food prices rose 4.1 percent from the last month of 1949 to June 1950. In June, they were slightly lower than a year earlier, and 14.6 percent below their postwar peak. The major rise took place during the second quarter.

TABLE 2.—*Changes in wholesale prices*

Commodity group	Percentage change		
	December 1948 to June 1949	June 1949 to December 1949	December 1949 to June 1950
All commodities.....	-4.9	-2.1	+4.0
Farm products.....	-4.8	-8.2	+7.1
Foods.....	-4.6	-4.1	+4.1
Other than farm products and foods.....	-5.0	-1	+2.3
Hides and leather products.....	-3.5	+.6	+1.5
Textile products.....	-5.2	-.5	-1.2
Fuel and lighting materials.....	-5.2	+.3	+1.8
Metals and metal products.....	-3.9	+.4	+2.4
Building materials.....	-5.3	-.5	+6.2
Chemicals and allied products.....	-11.0	-1.3	-.6
Housefurnishing goods.....	-2.1	-.8	+1.9
Miscellaneous.....	-6.3	-.3	+3.7
Special groups:			
Raw materials.....	-4.5	-3.0	+5.1
Semimanufactured articles.....	-8.9	-1.2	+2.3
Manufactured products.....	-4.4	-1.8	+3.7

Source: Department of Labor. (See appendix table B-22.)

Since the recent change in the international situation, wholesale farm prices have risen 6 percent and food prices have gone up 7 percent. The increase in farm prices is not quite as large as that which took place during the first six months of 1950 but the increase in food prices is greater. Farm and food prices are now at the highest levels since the beginning of 1949. A large part of these increases is due to the advances in livestock and wholesale meat prices, which rose 9 percent and 10 percent respectively. Although we are now in the period when supply seasonally declines, these increases are far greater than would appear to be warranted by seasonal factors, particularly since prices of these products were high before the Korean development. Cotton and soybean prices also rose sharply, as well as prices of fats and oils. The rise in cotton prices has been in part due to a substantial reduction in acreage, and in part to speculation.

Industrial prices rose 2.3 percent during the half year, but in June they were 3.1 percent below their postwar peak. During the first quarter, these prices continued the over-all stability which had characterized

them since last June. This over-all stability was, however, the composite of diverse movements. The prices of building materials were moving up. Later in the quarter, textile prices began to decline, while those of chemicals and some metals began to rise.

During the second quarter, as demand continued to expand, the general level of industrial prices rose moderately. The increases were particularly marked for such materials as nonferrous metals, lumber, scrap steel, and rubber. Textile prices, after some further decline, began to move up in June. Chemical prices first showed strength and then declined, mainly those of fats and oils.

The events in Korea have had a less pronounced effect thus far on the general level of industrial prices than on farm and food prices. Since that situation developed, industrial prices have advanced about 1½ percent. However, individual commodities, mainly raw and semifinished, such as tin, lead, many textiles, and chemicals, have advanced very sharply.

The steady advance in the prices of building materials during the half year reflected the boom in residential construction. Building materials prices increased 6.2 percent, and are up 7.4 percent from their August 1949 low. They have now virtually regained their postwar peak. There has been a very sharp rise in lumber prices, and in June they hit a new postwar peak. Other prices showed only moderate changes during the first half of the year, although brick and tile, cement, and structural steel reached new postwar peaks. Paint and paint material prices have continued to decline, with supplies of raw materials ample. The rise in building materials prices has been accompanied by some increase in the prices of houses.

The prices of copper and zinc also advanced sharply, reflecting the boom in durable goods, as well as purchases for the stockpiling program. Supplies of copper and zinc are below present levels of demand. Beginning in March, the price of zinc underwent a series of increases which raised it 50 percent. Copper began to advance in April, rising 22 percent to a level 1 cent below its postwar peak of 23.4 cents per pound. On the other hand, the price of lead displayed weakness during this period, as supplies were ample to meet demand and the needs of the stockpile program were not great. However, in July, the price of lead advanced 9 percent.

Capacity operations in steel increased the demand for scrap steel greatly, causing prices to rise sharply. Then, after approaching their postwar peaks, a moderate reaction occurred. Although no general advance in steel prices occurred, individual companies raised their prices on particular products, while so-called conversion deals were numerous.

Rubber prices have more than doubled during the first half of 1950. The rise resulted partly from interruptions in normal marketing, caused by political difficulties in the Far East, but primarily because demand was increasing, particularly in the United States. In June, this market also reacted somewhat, but late in the month under the influence of the develop-

ments in Korea, rubber prices rose again to exceed their previous peak. Increases in tire prices accompanied the rise in rubber prices, and the advances in the prices of other industrial materials were accompanied by some less extensive price advances at subsequent levels of fabrication.

Consumers' prices. Consumers' prices rose 1.6 percent from December 1949 to June 1950. They fluctuated moderately during the first four months, but increased sharply in May and June. The rise from April to May was 1.3 points or 0.8 percent, and from May to June 1.6 points, or almost 1 percent—the greatest monthly increases since July 1948. In June, the consumers' price index was slightly above the level of a year earlier, and 2.5 percent below its postwar peak. The sharp rise in wholesale food prices since Korea indicates that retail food prices will probably increase sharply in July, thus advancing the level of consumers' prices. Consumer incomes have risen somewhat more than the increase in consumers' prices, so that the real purchasing power of consumers increased moderately during the half year.

The fluctuations in retail food prices have accounted for most of the changes in the consumers' price index. Changes in other retail prices have been moderate. Rents continued their steady upward creep. Apparel prices, which had declined steadily from late 1948, leveled off. The cost of electricity and refrigeration rose slowly. Fuel prices rose through the first four months of the year, and then declined seasonally. (See chart 8, table 3, and appendix table B-21.)

TABLE 3.—*Changes in consumers' prices*

Item	Percentage change		
	December 1948 to June 1949	June 1949 to December 1949	December 1949 to June 1950
All items.....	-1.1	-1.2	+1.6
Food.....	-.3	-3.4	+3.7
Apparel.....	-5.0	-2.4	-.4
Rent.....	+.9	+1.3	+1.4
Fuel, electricity, and refrigeration.....	-1.6	+3.0	-.6
Housefurnishings.....	-5.7	-1.0	-.1
Miscellaneous.....	+.1	+.8	-.1

Source: Department of Labor. (See appendix table B-21.)

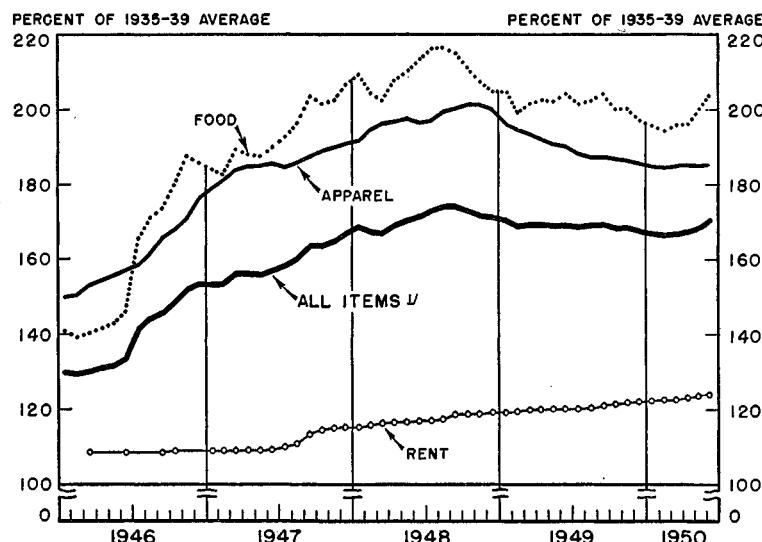
Wages and related matters

Total wage and salary payments reflected the general pickup in economic activity during the first half of 1950. (See appendix table B-5.) They rose to a seasonally adjusted annual rate of 139.8 billion dollars in the second quarter, an increase of 4.6 billion dollars over the second quarter of 1949 and 4.3 billion over the first quarter of 1950. This increase was due mainly to rising employment levels and higher wages for manufacturing workers, although increased overtime also had some influence.

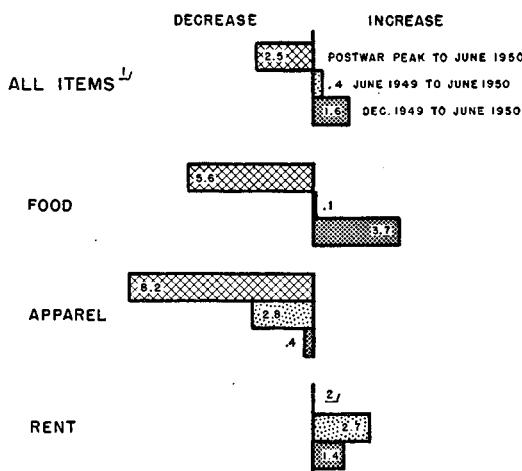
CHART 8

CONSUMERS' PRICES

Consumers' prices, after moderate fluctuations during the first four months of 1950, increased sharply in May and June because of large advances in retail food prices. Rents continued to rise. Other prices showed slight change.



PERCENTAGE CHANGES



^{1/} ALSO INCLUDES HOUSEFURNISHINGS, FUEL, ELECTRICITY, REFRIGERATION, AND MISCELLANEOUS GOODS AND SERVICES NOT SHOWN ON THIS CHART.

^{2/} JUNE 1950 IS POSTWAR PEAK.

SOURCE: DEPARTMENT OF LABOR.

Average hourly earnings in manufacturing reached an all-time high of \$1.45 in June of this year, about 5 cents higher than a year earlier. These increases have occurred in both durable and nondurable manufacturing. The new minimum wage also brought about slight advances in average hourly earnings in such industries as lumber and wood products, tobacco, and apparel. Average weekly earnings of manufacturing workers reached a new record level of \$58.89 in June, about \$4.38 above June 1949. (See appendix tables B-11, B-12, and B-13.)

In general, the pressure for wage advances in some industries and for pension and insurance plans in others continued strong throughout the first half of 1950. General wage advances were made oftener in nonmanufacturing industries than in manufacturing; wage advances were particularly noteworthy in the construction industry. The spread of pension plans continued at a rapid pace. The number of organized workers affected by new pension plans or by increased employer contributions to established plans negotiated during the first five months of 1950 exceeded the total for all of 1949. Many of the negotiations in 1950 were characterized by less hesitancy than usual about making long-term commitments. Most of the agreements negotiated this year, in contrast with many of last year's contracts, do not contain wage reopening privileges that can be exercised before the end of the first contract year.

The contract announced on May 23 between General Motors and the UAW-CIO is highly significant, because there are no provisions for reopening the contract within a five-year term. It also carried forward the two basic principles underlying the wage provisions of the 1948 contract. First, it provides for quarterly cost-of-living adjustments of 1 cent for each 1.14 points change in the Bureau of Labor Statistics Consumers' Price Index, without limit upward, but reaching a lower limit at 3 cents below the present cost-of-living allowance. Second, it provides for annual 4-cent increases in wage rates based on a technological "improvement factor" in place of the similar 3-cent provision of the previous agreement. Thus the new contract gives renewed recognition to the principle of sharing productivity gains with workers on a regular basis.

The company has also agreed upon company-financed pensions integrated with Federal old-age and survivors insurance for workers retiring at 65 years or older with at least 10 years of service. Unlike other recent labor-management contracts, the agreement provides for monthly benefits exceeding \$100 in the event of higher Federal old-age benefits. The agreement allows retirement for disability after 15 years of service and age 50, liberalizes the present insurance plan without additional cost to employees, and provides for company payment of half the cost of hospitalization and surgical benefits for workers and their families.

The agreement between the United Mine Workers and the bituminous coal operators provided for a general wage increase of 70 cents a day, raising the daily rate to \$14.75, and increased the operators' contributions

to the welfare fund from 20 cents per ton to 30 cents. The contract runs until June 30, 1952, subject to earlier termination on or after April 1, 1951. Anthracite miners and the Progressive Mine Workers of America were provided with adjustments similar to those in the bituminous contract.

During the first five months of 1950, 20.4 million man-days of idleness resulted from work stoppages, or twice as many as the 10.2 million man-days idle during the first five months of 1949. This was due largely to the Chrysler tie-up, which kept about 90,000 workers idle for 99 days, and to the extended coal stoppages which finally involved over 300,000 miners. The number of work stoppages was about 1,545 in the first five months of 1950, compared with 1,612 stoppages in the first five months of 1949.

The 99-day Chrysler controversy was ended on May 4 with an agreement which provides pension and social insurance benefits, increased vacation pay for some workers, and some job and interplant wage adjustments. The wage disputes in the telephone industry are now in the process of being settled, company by company.

Profits

The general expansion in economic activity, and the rise in wholesale prices during the first half of 1950, brought a sharp rise in business profits. In the second quarter of 1950, corporate profits before taxes (not adjusted for inventory valuation) were running at an estimated seasonally adjusted annual rate of 31.0 billion dollars, compared with 26.4 billion at their low point in the second quarter of 1949, a rise of 4.6 billion or about 17 percent. During the same period, the gross national product rose 12.8 billion dollars, or about 5 percent, demonstrating the greater volatility of the profit structure. Corporate profits before taxes reached their postwar peak in the third quarter of 1948, at an annual rate of 35.3 billion dollars. (See chart 9 and appendix table B-29.)

After taxes, corporate profits in the second quarter of 1950 were at an estimated seasonally adjusted annual rate of 18.9 billion dollars, compared with 16.4 billion dollars in the second quarter of 1949. This represents a return of over 4.5 percent on sales and almost 9 percent on net worth, compared with over 4 percent and 8 percent respectively a year earlier.

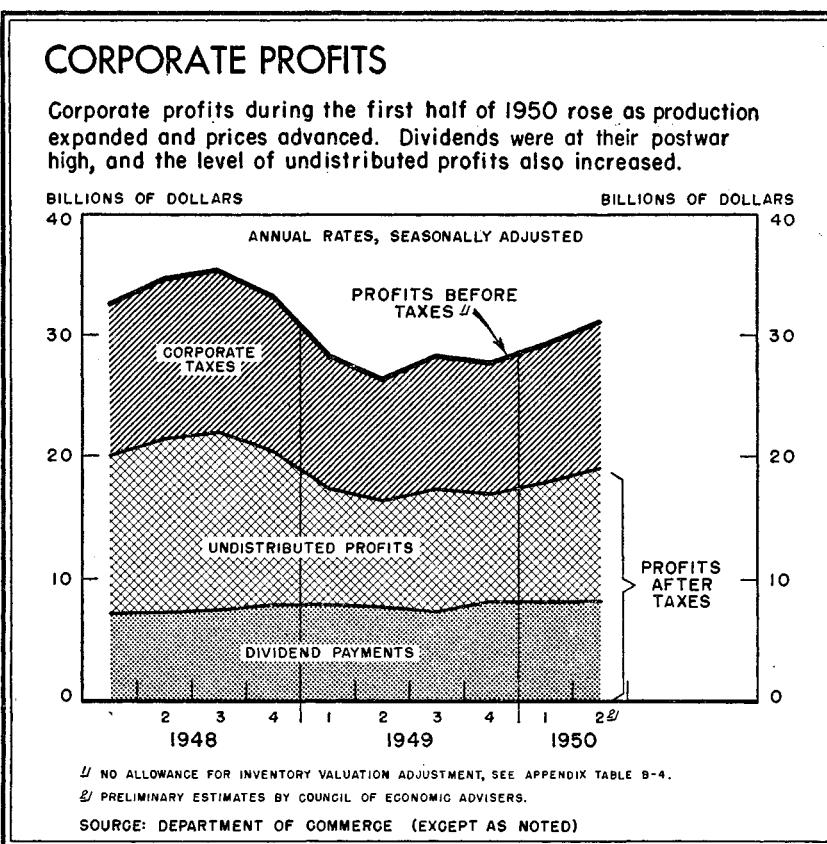
Net income of farm proprietors before taxes in the second quarter of 1950 (after adjusting for changes in the value of physical inventories and for seasonal variations) was at an annual rate of 11.6 billion dollars, compared with 13.7 billion a year earlier, a decline of 15 percent. This was 1.2 billion dollars below the first quarter level. The rise in farm prices during the first half of 1950 was not sufficient to offset the effects of lower marketings and higher costs.

Net income of unincorporated business and the professions (not adjusted for inventory valuation) in the second quarter of 1950 was at a seasonally adjusted annual rate of 23.6 billion dollars before taxes, compared with 20.1 billion dollars in the second quarter of 1949, a rise of about 17 percent.

This income component had been remarkably stable throughout 1949. (See appendix table B-4.)

Although the general level of corporate profits was substantially higher than a year earlier, the profit experience was markedly divergent among industries. In the manufacturing field, the profits before taxes of such industries as electrical machinery, automobiles, chemicals, building materials, rubber products, paper and allied products, and textiles were considerably higher during the first quarter of 1950 than a year earlier. On the other hand, in such industries as apparel, petroleum, iron and steel, machinery, transportation equipment, and nonferrous metals, profits during the first quarter of 1950 were substantially below their levels a year earlier, although in most cases they were running well above their 1949 low points. The differential structure of profits reflects the uneven impact of the increase in the demand for different commodities, as well as the effect of special factors such as that of the coal strike on the operation of the steel industry. The expansion in the level of activity during the second quarter of 1950 has improved the profit position of most industries. (See appendix tables B-31 and B-32.)

CHART 9



There continues to be a significant difference in the profit experience by size of firm. The manufacturing corporations having assets of less than 1 million dollars reported profits in the first quarter of 1950 well below the levels of a year earlier. The larger corporations were doing about as well as a year earlier, while the largest corporations with assets of over 100 million dollars were doing better. The lag in earnings of the smaller firms is accounted for by the fact that sales for these concerns during the first quarter of 1950 were still substantially below the level of early 1949, while the sales of the larger concerns were about as large. (See appendix table B-33.)

The availability of profits as a source of funds for different purposes is greatly influenced by the trends in prices. When prices are rising, as they were in the postwar period through 1948, part of the profits are locked up in the higher replacement costs of inventories. When prices are falling, affecting adversely the level of profits as in 1949, the lower replacement costs of inventories free funds for other purposes. The funds thus freed offset to that extent the reduction in profits as a source of funds for such purposes as expansion of plant and equipment and the payment of dividends. During the first half of 1950, wholesale prices rose, thus increasing the replacement costs of inventories.

As the following table shows, the net availability of funds from corporate profits after taxes, after allowing for the change in the costs of replacing inventories, was at an annual rate of 16.8 billion dollars in the first half of 1950. While about 12 percent below the level in the first half of 1949, this level was high enough to permit a further substantial increase in the liquid assets of corporations after increasing the volume of dividends and financing a high level of plant and equipment. (See table 4 and "Corporate Finance" in the section on Business Investment and Finance.)

TABLE 4.—*Corporate profits and changes in costs of replacing inventories*
[Billions of dollars]

Period	Corporate profits		Changes in costs of replacing inventories ¹	Net funds available from corporate profits for other purposes, after allowing for changes in costs of replacing inventories
	Before taxes	After taxes		
1946	23.5	13.9	5.2	8.7
1947	30.5	18.5	5.8	12.7
1948	33.9	20.9	2.0	18.9
1949	27.6	17.0	-2.2	19.2
<i>Annual rates, seasonally adjusted:</i>				
1949—First half	27.4	16.9	-2.2	19.1
Second half	27.9	17.1	-2.2	19.3
1950—First half ²	30.1	18.4	1.6	16.8

¹ Inventory valuation adjustment with sign reversed.

² Estimates based on incomplete data; second quarter by Council of Economic Advisers.

NOTE: Detail will not necessarily add to totals because of rounding.

Source: Department of Commerce (except as noted).

The generally rewarding level of profits, reflecting the improved business situation, has been one of the factors which encouraged business to expand its plant and equipment expenditures substantially above levels previously anticipated. (See appendix table B-17.) In the main, the level of profits is ample enough to provide funds for a volume of investment higher than that being currently undertaken, although many firms are exceptions.

MONEY AND CREDIT

The general upturn in business has been accompanied by a large rise in credit during the first half of 1950. In contrast to early 1949, when most types of credit expanded only slightly or declined, credit developments this year have closely paralleled the expansionary pattern of 1948.

In the first six months of last year, total commercial bank loans contracted by 1.5 billion dollars. The decline came to an end during the summer, and in the autumn a marked rise got actively under way. During the last quarter of 1949, such loans expanded 1.3 billion dollars, or 500 million dollars more than in the fourth quarter of 1948. In the first six months of 1950, loans of commercial banks rose 1.8 billion dollars, or about the same as in the corresponding period of 1948. (See table 5 and appendix table B-25.)

The rise in bank credit and other types as well during the first half of this year reflected a very active demand for consumer and mortgage credit, and credit for purchasing securities. Business loans showed a moderate seasonal decline, but much smaller than last year's.

The total dollar volume of nonfarm mortgage recordings made by all types of financial institutions attained a record level—nearly 7 billion dollars—during the first six months of the year, nearly 30 percent above the corresponding period of last year and almost 20 percent above the first half of 1948. The net increase in mortgage debt was nearly 2.5 billion dollars, bringing the total up to over 39.5 billion dollars at the end of June. An important factor was the large-scale mortgage purchases of the Federal National Mortgage Association.

TABLE 5.—*Money and credit expansion—selected items*
[Billions of dollars]

Item	Percentage change during the first half of year ¹		
	1948	1949	1950 ²
Commercial banks:			
Loans.....	+1.8	-1.5	+1.8
Investments: total.....	-4.2	+.9	+.3
U. S. Government securities.....	-4.4	+.6	-.6
Weekly reporting member banks:			
Loans: total.....	+.4	-1.7	+.7
Commercial, industrial, and agricultural.....	-.3	-2.4	-.3
Instalment credit.....	+1.1	+.5	+1.1
Privately-held money supply.....	-4.3	-3.5	+.5

¹Change based on data for December 31 and June 30.

²Estimates based on incomplete data; by Council of Economic Advisers.

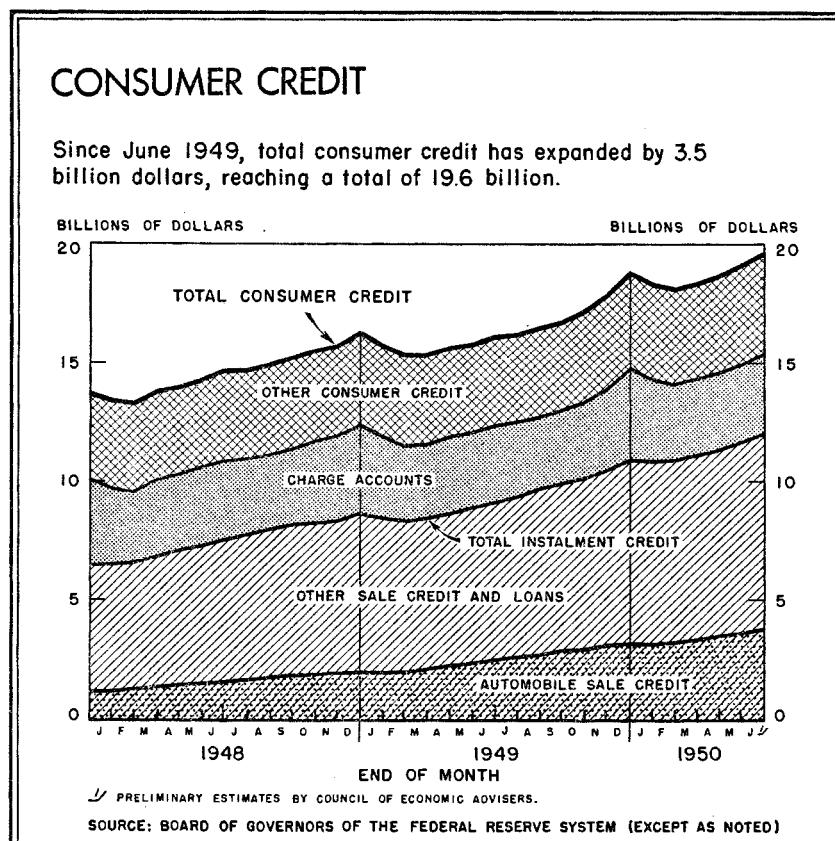
Source: Board of Governors of the Federal Reserve System (except as noted).

Consumer instalment credit has been steadily rising since last spring, and at the end of June reached a total of 12.0 billion dollars and was 2.9 billion dollars above the level of a year earlier. During the first half of this year, the rise was more than twice as large as in the first six months of 1949. Accompanying this rise, there has been a progressive relaxation of credit terms. (See chart 10 and appendix table B-24.)

Credit for purchasing or carrying securities, most of which was advanced by banks, also has risen markedly over the last year, but still is very small in relation to total loans. Total customer borrowing on margin account has increased about 500 million dollars, or about 75 percent since June 30 of 1949. Total commercial bank loans on securities other than Federal Government securities amount to less than 5 percent of their total loans.

A seasonal decline in business loans is to be expected during the first part of the year. This year the decline was very moderate. At the city banks, a 300-million-dollar decline in business and agricultural loans was reported for the first six months. It was no greater than the decline which occurred in the first six months of 1948, and 2 billion dollars smaller than

CHART 10



last year's. In June, business loans of city banks started to rise again at a substantially more rapid rate than in 1948, whereas in 1949 it was August before the contraction ended. Inventory buying associated with recent international events probably will not be reflected in bank credit until later. (See appendix table B-25.)

As a result of the concentration of tax payments which is normal for the first quarter, and a decline of more than 3 billion dollars in the holdings of Government securities by Federal Reserve and commercial banks, the money supply (privately-held deposits and currency) decreased by about 2.7 billion dollars in the first quarter of 1950. (See appendix tables B-26 and B-27.) The decline, however, was only about one-half as large as occurred in the first quarters of 1948 and 1949. The smaller first quarter drain on private deposits this year was primarily a reflection of the change in the Government's financial position brought about through smaller tax payments and larger Government cash expenditures. In the second quarter of the year, the money supply again rose substantially, more than offsetting the first quarter decline.

The rise in borrowing has not resulted in a general tightening in credit terms. Through the first half of the year, business loan rates and private security yields showed little change. Private financial institutions showed increased willingness to make mortgage loans on more favorable terms. (See appendix table B-28.)

In view of the substantial business recovery we have had in the past year, the over-all rise in bank credit did not appear alarming prior to the Korean development. But the rate at which credit has been advancing recently as shortages have appeared in many sectors of the economy is a cause for concern. Any substantial increase in defense expenditures will make necessary effective measures of credit restraint.

THE FLOW OF GOODS AND PURCHASING POWER

Personal income, consumption expenditures, and saving

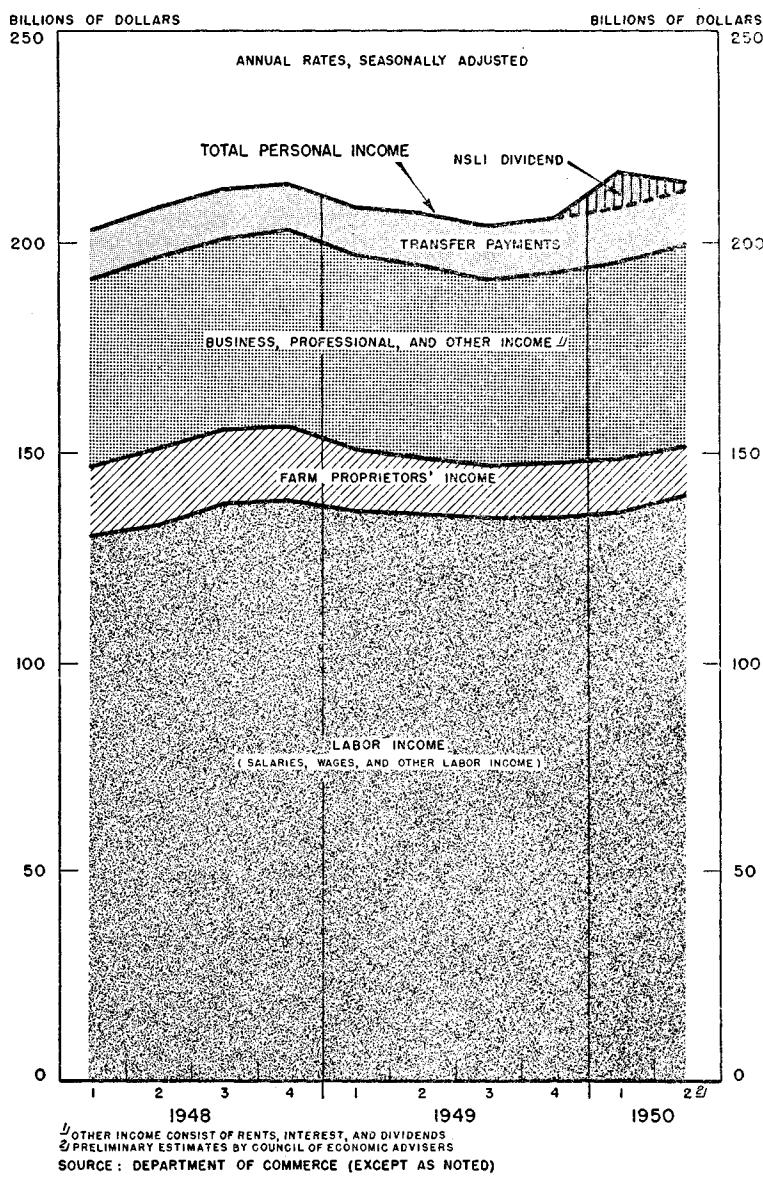
Personal income. Personal income in the second quarter of this year attained an annual rate of 213.7 billion dollars seasonally adjusted, a gain of 8.3 billion dollars, or 4 percent, over the last quarter of 1949. The decline of 2.7 billion dollars at an annual rate from the first quarter of this year was due to the reduced flow of payments on the veterans' life insurance dividend. All major components of earned income except farm and rental income were higher in the second quarter than in the first.

About 2.1 billion dollars (8.5 billion at an annual rate) was distributed to veterans as a dividend on National Service Life Insurance in the first quarter of the year. In the second quarter, the payment was largely completed by paying out an additional 500 million dollars (2.0 billion at an annual rate). Over 14.5 million veterans received checks which averaged about \$180 apiece. While actual payments were concentrated in the first quarter, the effects spread over a much longer period. Part of the rise in

CHART 11

PERSONAL INCOME

Personal income rose by almost 10½ billion dollars (annual rate), or 5.1 percent, from the second half of 1949 to the first half of 1950. The peak in the first quarter was caused by the veterans' dividend.



other income may be attributed indirectly to the dividend. (See chart 11.)

During the first half of 1950, total compensation of employees rose by 6.4 billion dollars to 146.6 billion dollars, but not all this increase was reflected in take-home pay. The social security tax was increased from 2 to 3 percent of covered wages, effective in January, and there was an increase in employer contributions to private funds, which are considered as an addition to the compensation of workers. (See appendix table B-6.)

Business and professional income also rose throughout the first half of this year. Farm income, the only principal component of income to decline, fell by almost 10 percent. Since 1948, the decline has been in the neighborhood of one-third. (See chart 11 and appendix tables B-4 and B-5.)

Almost all the increase in personal income was reflected in spendable income, which increased 4.2 percent during the half year. (See appendix table B-7.) Allowing for the lower level of prices, total real disposable income in the second quarter of 1950, although below the first quarter, was 2.8 percent higher than in the last quarter of 1948, the previous peak. But, because of the upward trend in population, there was very little increase in real per capita disposable income from the last quarter of 1948 to the second quarter of this year. (See appendix table B-8.)

Distribution of income. Data showing how income is distributed among high- and low-income receivers are not available for 1950. In the year 1949, for the first time since the end of the war, there was an increase in the proportion of the Nation's spending units having less than \$2,000 annual money income. Thirty percent of spending units in 1948 had incomes of less than \$2,000, compared with 36 percent in 1947. In 1949, the proportion increased to 33 percent. (See table 6.)

TABLE 6.—*Distribution of the Nation's spending units by income level*

Annual money income before taxes	Percent of all spending units				
	1945	1946	1947	1948	1949
Under \$1,000.....	20	17	14	12	14
\$1,000 to \$1,999.....	27	23	22	18	19
\$2,000 to \$2,999.....	23	25	23	23	21
\$3,000 to \$3,999.....	15	17	17	20	19
\$4,000 to \$4,999.....	7	8	10	12	11
\$5,000 to \$7,499.....	5	6	9	10	11
\$7,500 and over.....	3	4	5	5	5
All income groups.....	100	100	100	100	100

Source: Board of Governors of the Federal Reserve System.

The drop in farm income, and higher unemployment in 1949 than in preceding years, contributed to the rise in the proportion of units having less than \$2,000. Both farmers and unskilled workers fared less well than other occupational groups in 1949, according to the 1950 Survey of Consumer Finances. Recently, there has been a decrease in unemployment but no gain in farm income.

Personal consumption expenditures. Personal consumption expenditures at a seasonally adjusted annual rate of 184.5 billion dollars in the second quarter of 1950 were 3.9 billion dollars, or 2 percent, above the last quarter of 1949. Consumers' prices were slightly higher. (See charts 8 and 12.)

The payment of the NSLI dividend in the first quarter of 1950 undoubtedly had a major influence on the rise in consumer spending, especially on the purchase of durables. In 1949, the strongest factor in the consumer picture was the demand for automobiles, while sales of other durables and nondurables were substantially below 1948. Automobile sales continued to increase during the first half of this year. The most significant change from 1949, however, was an increase of about 10 percent in purchases of furniture and household equipment. Expenditures for food and other nondurables also increased, and expenditures for services continued to move upward, partly as a result of increases in rents and utility costs. (See appendix table B-2.)

Since mid-1948, service charges and rents have continued to rise, while prices of consumer goods have declined. Because of this, from the third quarter of 1948 total services have increased almost as much as total consumption expenditures. In actual quantities, however, purchases of goods increased as rapidly as purchases of services throughout 1948 and 1949 and more rapidly during the first half of 1950.

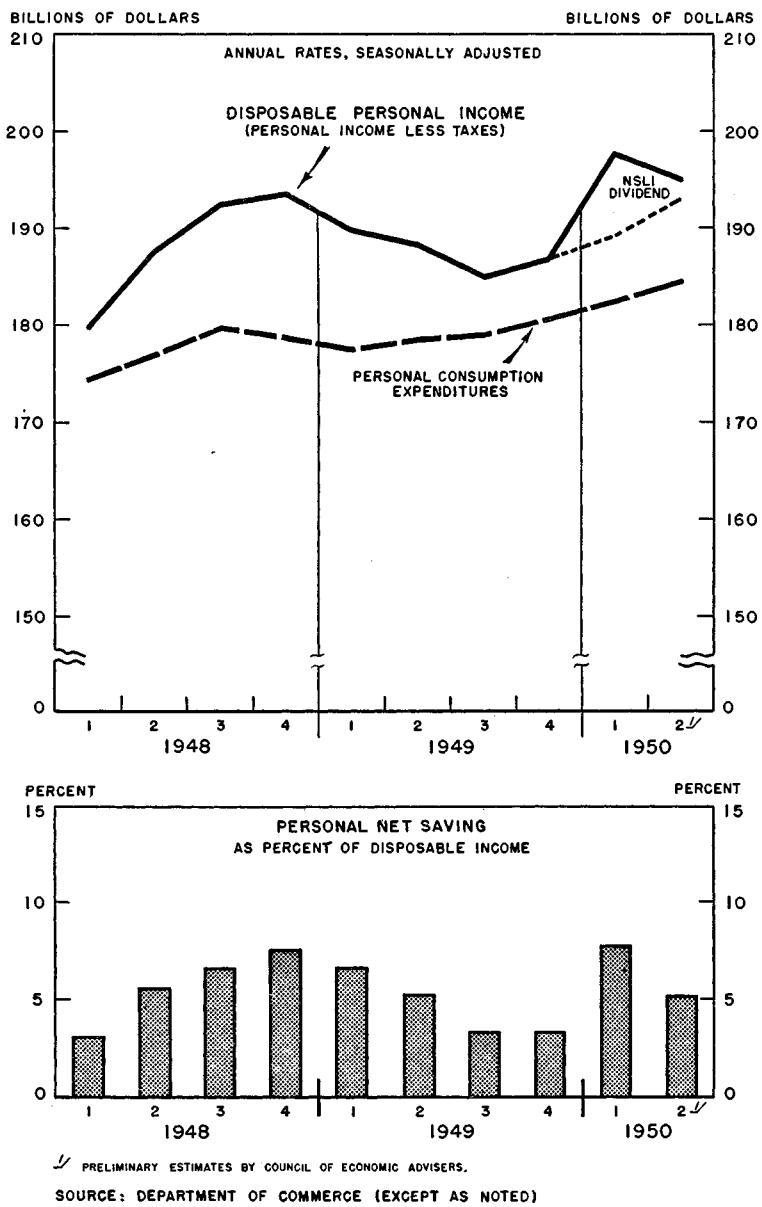
Personal saving and dissaving. The rate of saving in the first half of this year has been greatly distorted by the payment of 2.6 billion dollars of the veterans' dividend on National Service Life Insurance. A considerable part of this was used to add to liquid assets, to retire debt, or to buy homes, all of which adds to saving. The total volume of personal net saving rose from 6.2 billion dollars at an annual rate in the fourth quarter of 1949 to 15.3 billion in the first quarter of 1950, when most of the veterans' dividend was distributed. Personal saving then declined to 10.1 billion in the second quarter.

The rate of saving in relation to disposable income in the postwar period has fluctuated greatly. After reaching a low in the second quarter of 1947, savings rose rapidly to a peak in the fourth quarter of 1948, and then declined as income declined in 1949. A major part of the fluctuation was probably due to changes in direct investment in personal business, particularly in inventories, while "household" saving has been more nearly constant. The sharp rise in saving in 1948 was associated with tangible investments in farms, businesses, and homes, while the increase in debt was larger than the increase in financial assets. (See table 7.) In the recession year 1949, on the other hand, increases in financial assets were slightly greater than in 1948, and there was a less rapid growth in mortgage debt, consumer credit, and personal business debt. Investment in homes declined moderately, and investment in personal businesses dropped by 5 billion dollars. Similar detail is not available for 1950, but it is evident that, as a result of the

CHART 12

PERSONAL INCOME, SPENDING, AND SAVING

Consumer incomes rose substantially in first half of 1950 due in part to payment of the National Service Life Insurance dividend. Expenditures rose less than income and the rate of saving increased.



veterans' dividend, cash and deposit holdings, after allowance for seasonal factors, have increased at a more rapid rate than in the rise in debt.

The net addition to personal saving of 10.9 billion dollars in 1948 and 8.6 billion in 1949 represents a much larger total saving on the part of those families whose assets increased more than their debts, offset in part by dissaving on the part of other families. Slightly more than 3 out of every 10 spending units spent more than they earned in 1949, a somewhat larger proportion than in 1948, according to the 1950 Survey of Consumer Finances. In 1949, as in previous years, large numbers of families at all income levels spent more than they earned. Between 1948 and 1949, however, the increase in dissaving was almost wholly among families with incomes under \$3,000.

TABLE 7.—*Components of personal saving*
[Billions of dollars]

Item	1948	1949
Increase in financial assets.....	7.8	8.0
Currency, deposits, U. S. Government bonds, and saving and loan shares.....	1.4	1.9
Insurance reserves (private).....	3.5	3.8
Corporate and State and municipal securities.....	2.9	2.4
Less: Increase in debt.....	9.5	8.0
Mortgage debt (residential).....	4.1	3.5
Consumer debt.....	2.5	2.3
Business debt.....	2.9	2.2
Equals: Net financial saving.....	−1.7
Plus: Net tangible investment.....	12.6	7.0
Personal business investment.....	6.4	1.3
Purchases of new homes.....	6.2	5.6
Plus: Errors and omissions.....	1.6
Equals: Net personal saving.....	10.9	8.6

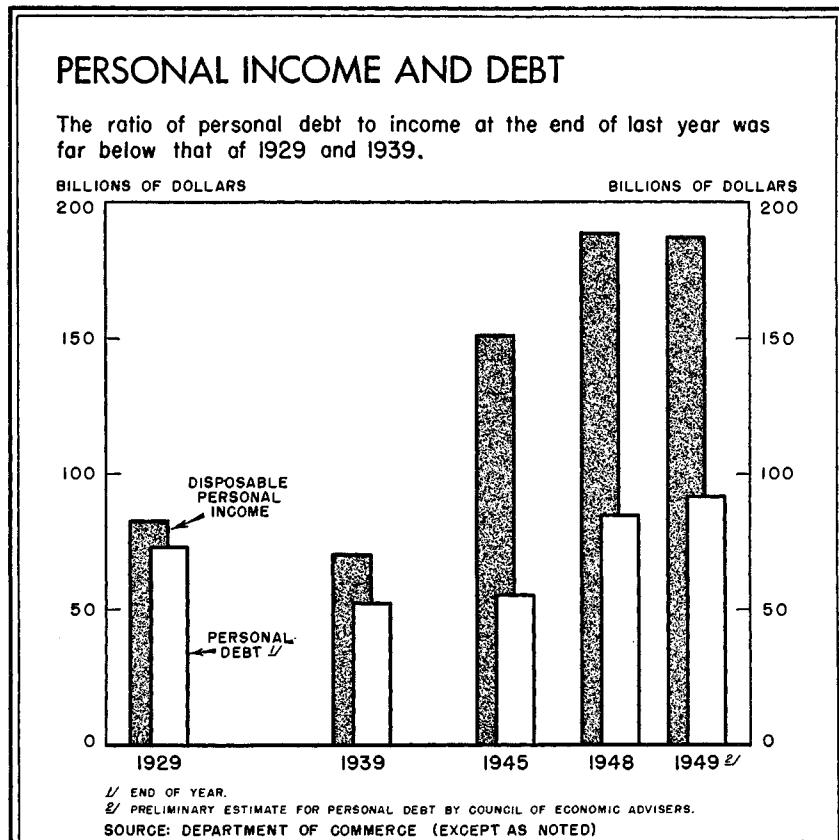
NOTE.—Detail will not necessarily add to totals because of rounding.

Sources: Department of Commerce and Securities and Exchange Commission.

Dissaving may take the form of liquidating bank deposits or other assets, or increases in consumer credit. The rapid rate of increase in consumer debt in the latter part of 1949 has been resumed, after the normal seasonal contraction, during the first part of this year. The veterans' dividend had no discernible effect in reducing instalment debt, and in the case of automobile purchases it may have stimulated debt incurrence by furnishing a down payment. As shown in chart 10, by the end of June 1950 consumer debt had risen to 19.6 billion dollars, or over 3.5 billion above a year earlier. The ratio of consumer debt to disposable income was only slightly below that during the same period in 1939. Mortgage debt also rose rapidly in 1949 and the first half of this year.

The rapidity of the rise in personal debt, which has been growing faster than income since 1947, has given rise to some concern that the volume of debt is becoming too high for economic stability. In 1949, over 50

CHART 13



percent of consumer units had debts of some kind, about 20 percent had mortgages on homes, and 22 percent had instalment debt. However, total personal and noncorporate debt and interest in relation to incomes are now much lower than prewar. As chart 13 shows, the ratio of noncorporate debt to personal disposable income has fallen from 87 percent in 1929 and 74 percent in 1939 to 47 percent in 1949. As a result of the lower debt ratio and of lower interest rates, the ratio of personal interest payments to disposable income was only 2.7 percent in 1949, compared with 7.9 percent in 1929 and 4.6 percent in 1939. Furthermore, many families who have gone into debt also have reserves of liquid assets. Since the war, financial assets have grown as rapidly as personal debt.

The stock of financial assets in the hands of consumers, farmers, and personal business is now above 400 billion dollars or over twice as great as annual disposable personal income. About half these assets are in a form readily convertible into cash. The ratio of total financial assets to income has fallen since 1939, principally because of the rise in the price level. The ratio of liquid assets, including cash, Government bonds, and saving and

loan shares, to personal income after taxes has risen from about 80 percent to over 100 percent.

Nevertheless, there are disturbing factors in the debt and asset situation. The distribution of liquid assets is highly concentrated in the upper income groups. The upper 20 percent of families, in terms of annual income, owned 54 percent of bank deposits and Government bonds in early 1949. These groups also hold large amounts of corporate and State-local securities which are not commonly owned by families with less income. At the beginning of 1950, 31 percent of all spending units had no Government savings bonds or bank deposits, a slightly higher proportion than in 1949, and 58 percent had less than \$500. (See table 8.) Fifty-six percent of the spending units in the under \$1,000 income group, and 39 percent in the \$1,000-\$3,000 income group, had none of these assets at the beginning of 1950. This concentration of liquid assets among higher income groups does not provide as accessible a reservoir of purchasing power as if they were more broadly distributed.

Moreover, while the level of personal debt and the interest burden are still relatively low, some categories of debt have been rising very rapidly, particularly consumer instalment debt and mortgage debt. The increase in consumer credit, which has been stimulated by progressive lengthening of repayment periods and lower down payments, has been a potent factor in the high and increasing demand for houses and for consumers' durables. The stepped-up military requirements since the Korean development will involve increased demands for many of the important types of materials which are already in short supply and which are used in the production of these consumer items.

TABLE 8.—*Percentage of the Nation's spending units having no liquid assets or less than \$500¹*

Asset holdings and period	Annual money income before taxes				
	All spending units	Under \$1,000	\$1,000-\$2,999	\$3,000-\$4,999	\$5,000 and over
No liquid assets:					
1947	24	51	27	10	2
1948	27	56	34	14	2
1949	29	56	38	19	5
1950 ²	31	56	39	21	4
Liquid assets of less than \$500 or no liquid assets:					
1947	50	78	58	34	10
1948	54	77	66	45	15
1949	57	79	67	54	22
1950 ²	58	78	68	53	26

¹ Includes deposits, saving and loan shares, and U. S. Government bonds. Does not include currency.

² Estimates based on incomplete data.

Source: Board of Governors of the Federal Reserve System.

Business investment and finance

Gross private domestic investment during the second quarter of 1950 was running at a seasonally adjusted annual rate of 44.0 billion dollars, compared with the low point of 31.2 billion in the fourth quarter of 1949, a rise of nearly 13 billion. (See chart 14, table 9, and appendix table B-3.) During the same period, the gross national product increased by 14.2 billion dollars, from a seasonally adjusted annual rate of 253.8 billion to 268.0 billion. (See appendix table B-1.)

The all-time peak rate of gross private domestic investment (46.8 billion dollars) was reached in the fourth quarter of 1948. This was 17.5 percent of the gross national product, contrasted with 16.6 percent for the year 1948, 12.9 percent for the year 1949, and 16.4 percent in the second quarter of 1950.

The greater part of the fluctuation in total business investment in the past 2 years has occurred in the inventory component. As table 9 shows, the annual rate of business investment exclusive of inventories (i. e., investment in construction and equipment alone) dropped by only 2.5 billion dollars from the fourth-quarter 1948 peak to the third-quarter 1949 low, and then rose by 5.7 billion dollars to an all-time record rate of 42.0 billion in the second quarter of 1950. New highs were also reached in the second quarter in outlays for producers' durable equipment and for private housing, the two largest components of the private construction and equipment total.

TABLE 9.—*Gross private domestic investment*¹

[Billions of dollars, annual rates, seasonally adjusted]

Period	Total gross private domestic investment	Construction and equipment				Inventory change ²
		Total	Nonfarm residential construction	Other private construction	Producers' durable equipment	
1948: Second half.....	46.2	38.7	8.6	9.4	20.6	+7.6
1949: First half.....	34.4	36.9	7.7	9.3	20.0	-2.5
Second half.....	31.6	36.6	8.9	8.6	19.0	-5.0
1950: First half ³	42.2	40.6	11.3	8.9	20.4	+1.6
1948: Third quarter.....	45.7	38.6	8.8	9.4	20.4	+7.1
Fourth quarter.....	46.8	38.8	8.3	9.5	20.9	+8.0
1949: First quarter.....	37.5	37.2	7.8	9.4	20.1	+.3
Second quarter.....	31.3	36.6	7.6	9.2	19.8	-5.3
Third quarter.....	32.1	36.3	8.2	8.7	19.4	-4.2
Fourth quarter.....	31.2	36.9	9.5	8.6	18.7	-5.7
1950: First quarter.....	40.5	39.2	11.0	8.9	19.3	+1.3
Second quarter ⁴	44.0	42.0	11.6	8.9	21.5	+2.0

¹ See appendix table B-3 for further details.

² After inventory valuation adjustment.

³ Estimates based on incomplete data; by Council of Economic Advisers.

NOTE.—Detail will not necessarily add to totals because of rounding.

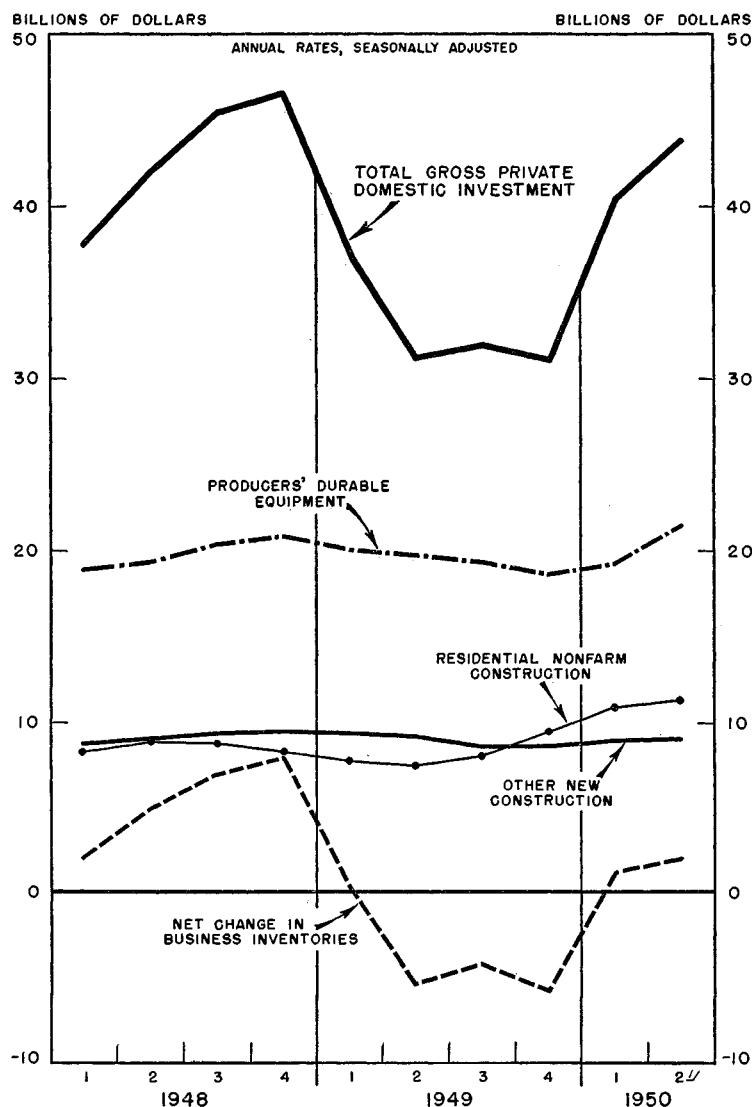
Source: Department of Commerce (except as noted).

Plant and equipment. After a steady but moderate decline during 1949, total outlays for plant and equipment (on a seasonally adjusted basis) rose

CHART 14

BUSINESS INVESTMENT

Most of the change in gross private domestic investment since early 1948 has reflected inventory movements. Investment in producers' equipment and in housing reached new highs in the second quarter of 1950.



✓ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED)

substantially during the first half of 1950. (See appendix table B-3.) These fluctuations reflect mainly a 1949 decline and a 1950 recovery in purchases of equipment.

An upward trend in new orders received by producers of machinery and equipment set in during the latter part of 1949, and became more pronounced in early 1950. There is no sign yet of any slackening in these orders. The general improvement in business conditions has created more optimistic anticipations, and greater stress is being placed on reduction of costs by replacement of obsolescent equipment.

The most recent survey of anticipated business plant and equipment outlays, conducted by the Department of Commerce and the Securities and Exchange Commission in April and May, pointed to a sustained high level of such investment during the latter part of this year. (See appendix table B-17.) For the third quarter, respondents anticipated plant and equipment outlays somewhat greater than those of the corresponding quarter of 1949, and much more than seasonally higher than those of the first quarter of 1950, when expenditures were curtailed by steel shortage due to work stoppages. The third-quarter outlook reported in the survey reflects the expectations of profitable investment by public utilities and manufacturers at higher levels than a year earlier; businessmen in the other major fields estimated their outlays in both the second and third quarters of 1950 at a little below those of a year before. On the basis of the reports for the first three quarters of 1950, it would appear that plant and equipment outlays for the whole year 1950 may set a new annual record in the gas and electric utility field, and may nearly equal 1949 for nonfarm business as a whole.

Nonfarm inventories. A major development during the first quarter of 1950 was the resumption of nonfarm inventory accumulation. This was a large element contributing to the recovery movement of the economy during the first half of the year. Under the stimulus of expansion in demand in the first half of 1950, the level of production was restored to the point where a substantial accumulation of inventories is again taking place.

During the first quarter, nonfarm inventories were being accumulated at a seasonally adjusted annual rate of 2.1 billion dollars. In the second quarter, the rate rose to 2.6 billion. Compared with a peak annual rate of liquidation of 4.7 billion in the fourth quarter of 1949, this represented a net upward shift of 7.3 billion, accounting for half of the total rise in gross national product. (See appendix table B-3.)

The rate of growth of inventories reached in the second quarter of 1950 may be slightly in excess of what will be needed on the average to keep pace with the historical long-run trend of business expansion. Stocks do not appear excessive in relation to current production and sales. At mid-

year, however, there were some evidences of efforts to accumulate extra inventories in anticipation of possible shortages.

The book value of business inventories in manufacturing and trade rose from 53.6 billion dollars at the end of December 1949, on a seasonally adjusted basis, to 55.2 billion dollars at the end of May 1950. In dollar terms, they were still about 6 percent below the peak level of 58.6 billion dollars reached in November 1948. But when adjusted for changes in prices, the current volume of inventories is probably close to the peak level.

The largest increases in book value of inventories have taken place in the trade segment. In the first five months of 1950, the book value of retail inventories increased about 4.2 percent and that of wholesale inventories about 4.7 percent, after allowance for seasonal variation. The increase in manufacturers' inventories was only 1.9 percent. During the previous period of inventory liquidation, the largest decline had been in manufacturers' inventories, which fell more than 11 percent from January to November 1949. Trade inventories fell 8 percent from the November 1948 peak to December 1949. (See appendix tables B-18, B-19, and B-20.)

Corporate finance. During the first half of this year, reflecting changes in working capital needs, the total financial requirements of corporations were considerably above the first half of 1949. In the first six months of last year, corporations liquidated about 4 billion dollars of their inventory holdings and accounts receivable. This year the working capital requirements of corporations increased. With their plant and equipment expenditures only 600 million dollars below the level of a year ago, their financial requirements for plant and equipment, inventories, and receivables were 4.5 billion dollars above the first half of 1949. Corporations continued to increase their liquid asset holdings at about the same rate as a year ago despite their larger requirements for funds. (See chart 15 and appendix table B-34.)

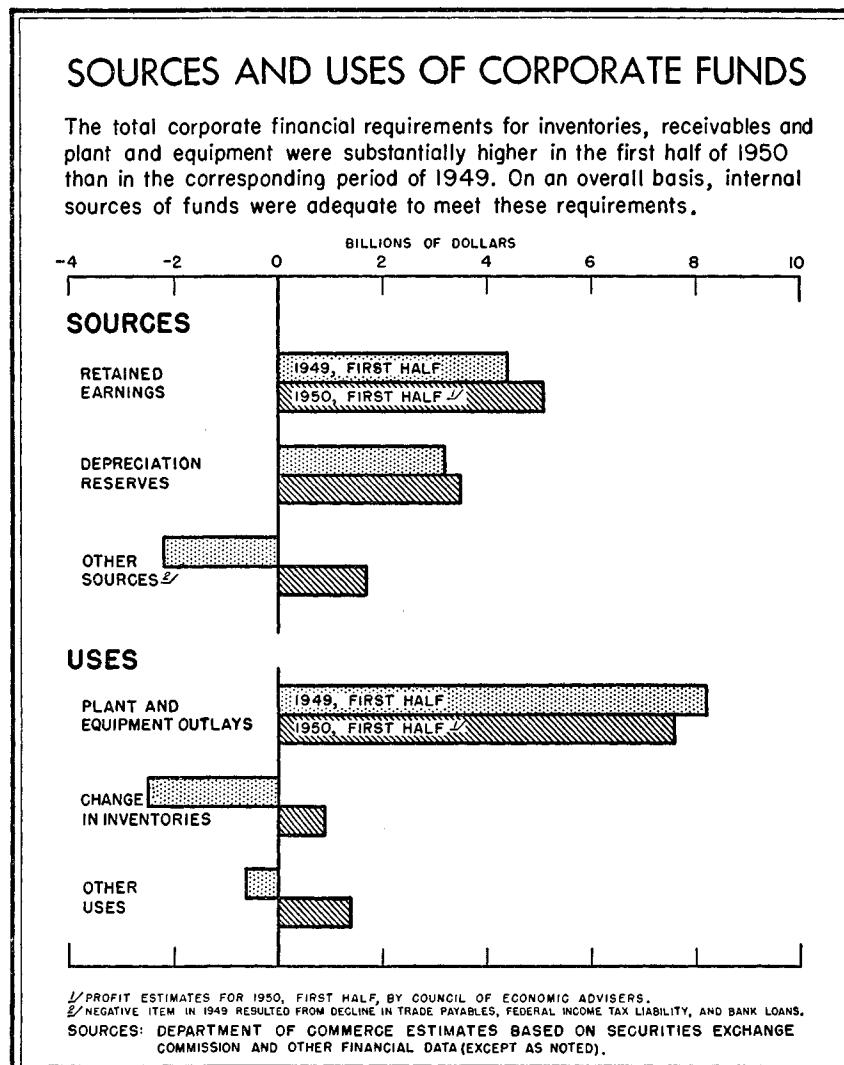
Corporations as a group were able to meet from internal sources of funds all of their financial requirements for plant and equipment outlays and for additions to inventories. During the first half of the year, rising total profit levels permitted an increase in retained earnings about 15 percent above the first six months of 1949, while dividend payments continued to increase. The total amount of funds obtained by corporations from outside sources was less than 2 billion dollars, and exceeded by only some 400 million dollars the amount corporations themselves invested in further liquid asset accumulation. Last year, when their investment in inventories and customer accounts was declining, corporations were able to finance their plant and equipment expenditures internally, and in addition they had sufficient funds to retire debt and accumulate liquid assets. The experience during the last 18 months, when corporations on balance were self-financing, is in striking contrast to the developments in the period

1946-48 when they needed more than 10 billion dollars annually from external sources.

New security issues (the bulk of which were public-utility issues) were the only important source of external funds during the first half of the year. The total volume of funds obtained from this source was about 1 billion dollars less than during the first six months of 1949; but a higher portion was in stock issues.

Corporate bank loans and trade debt showed a moderate seasonal decline during the first half of the year. To a smaller extent than last year proceeds from new security issues were used to retire bank loans.

CHART 15



Though there are substantial differences between the financial positions of large and smaller corporations, on an over-all basis corporate liquidity is very high at the present time. At the end of June, corporations held around 40 billion dollars in cash, deposits, and Government securities, only about 2 billion dollars less than their total accumulation at the end of the war. As a measure of their liquidity, the ratio of their cash, deposits, and Government securities to their current liabilities is now about 70 percent, compared with 61 percent at the end of 1948, 64 percent at the end of 1947, 93 percent at the end of 1945, and about 45 percent in 1940 and 1941.

This present high degree of liquidity of business corporations, together with rising profits and the favorable business outlook, should promote a continued high level of business investment and perhaps a further increase. The major problem now is to channel investment into those areas where it is most needed to support our increasing international commitments.

Construction. Construction activity was at a peacetime high during the first half of 1950 whether measured in dollars or in physical terms. It was a strong expansionary force during this period. Total new construction activity, including both public and private, was running at an annual rate of 26.4 billion dollars in June, about 20 percent higher than a year earlier. For the first half of 1950, total construction activity was at an annual rate of 25.9 billion dollars, up 17 percent from the first half of 1949. About three-fourths of the current outlay is private and one-fourth public. The new peak in construction activity is in major part the result of the housing boom, which began in the late spring of 1949. (See appendix table B-16.)

The very high current rate of construction involves heavy demands for labor and materials. Construction wages and the prices of building materials have been rising since midsummer of 1949.

Private construction activity during the first six months was at an annual rate of 19.1 billion dollars, a rise of 20 percent, compared with a year earlier. Nonfarm residential construction activity rose 47 percent, while other private construction declined about 5 percent. Nonfarm housing starts reached the unprecedented level of 142 thousand units in June, after making new records in March, April, and May with 110 thousand, 126 thousand, and 140 thousand, respectively. For the first six months, starts totaled 680 thousand compared with 449 thousand during the same period of 1949, a rise of over 50 percent. The unusually mild winter in much of the country was a factor in achieving this high level of starts, but housing starts have continued very high throughout the first half of the year.

The increase in the construction of private multifamily units, which was so noticeable in 1949, continued in 1950. Nearly 37 percent more multifamily units were started in the first six months of 1950 than in the same period of 1949, facilitated by the use of section 608 of the National Housing Act which provides for insurance of loans for rental projects.

Nonresidential private construction during the first half of 1950 was somewhat lower than in the first half of 1949. Construction of stores,

restaurants, and garages was slightly higher, while factory construction was considerably less. Industrial construction rose more than seasonally through the first half of 1950, however, and the increase in contracts indicates a further rise. Public utility construction outlays during the first half of 1950 were 6 percent below the first half of 1949, and farm construction was down 16 percent. On the other hand, private institutional construction was at higher levels during the first half of 1950 than a year earlier, with large rises reported for hospitals and religious institutions.

Public construction in the first half of 1950 was at an annual rate of 6.8 billion dollars, a rise of 9 percent over a year ago. The largest increases were for schools, hospitals, and other types of public building where the needs are still great. Expenditures for conservation and development also showed a large increase. Highway expenditures were slightly higher than during the first half of 1949.

Expenditures for public housing were substantially higher in the first half of 1950 than a year earlier, although the level of activity is still low. Moreover, after expanding rapidly in the second half of 1949, the rate of activity leveled off during the first half of 1950. During the first six months of 1950, the number of public housing starts was less than 10 thousand, compared with about 23 thousand in the same months of 1949. Most of the public housing has been under State or local auspices. Federal subsidized low-rent housing under the Housing Act has been relatively insignificant in amount.

International transactions

In the first half of 1950, both United States exports of goods and services and the surplus of these exports over imports were running at a rate of 4 to 5 billion dollars a year less than during the first half of 1949. With the shrinkage of United States exports that has taken place over the past 12 months, exports and the export surplus were reduced for the first time since the war to a proportion of the gross national product not significantly greater than before the war. Thus, their importance as a factor in the net demand for United States production was considerably reduced. Their relation to gross national product in recent periods, compared with prewar and with their postwar peak, is shown in table 10.

TABLE 10.—*United States international transactions as percent of gross national product*
[Percent]

Period	Exports of goods and services ¹	Imports of goods and services ¹	Export surplus ¹
1936-38 average.....	4.8	4.2	0.6
Annual rates:			
1947, first half (postwar peak).....	8.8	3.6	5.2
1949, first half.....	6.8	3.9	2.9
1950, first half ²	4.9	3.9	1.0

¹ Includes income on investments.

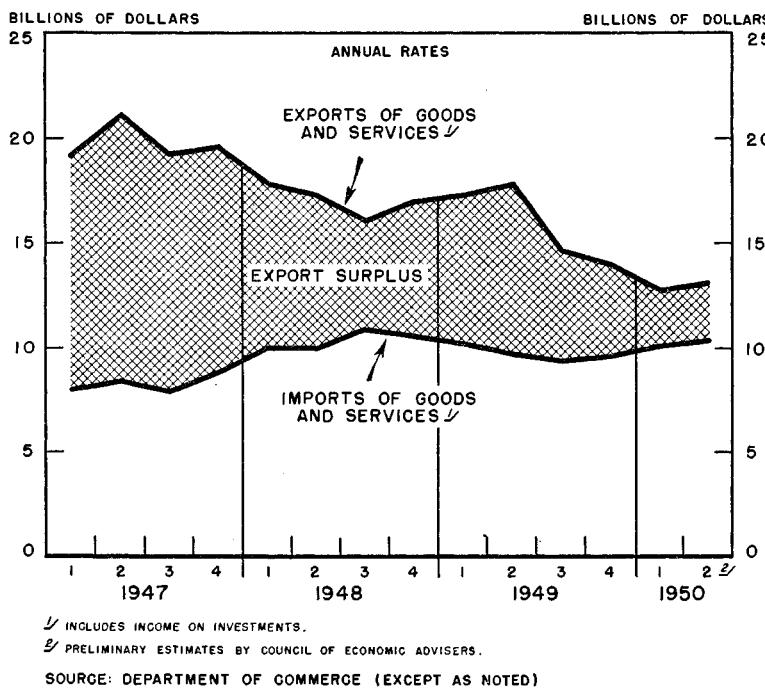
² Estimates based on incomplete data; by Council of Economic Advisers.

Source: Department of Commerce (except as noted).

CHART 16

EXPORTS AND IMPORTS OF GOODS AND SERVICES

The continued reduction in exports in the first half of 1950, together with the rise in imports, resulted in the lowest export surplus since the war.



The decline in the export surplus since the first half of 1949 resulted almost entirely from a fall in total exports; imports of goods and services rose only slightly in value. It should be noted that a considerable part of the decline in the export surplus and most of the decline in total exports had already taken place by the end of 1949. Further declines occurred in the first quarter of 1950 but in the second quarter it appears from preliminary data that the trend has been stopped. (See chart 16 and table 11.)

Although the value of imports of goods and services in the first half of 1950 was only slightly higher than in the first half of 1949, this value represented a significant increase above the second half of 1949, especially when seasonal factors in our imports of services are taken into account. The change in our export surplus since the second half of 1949 resulted about equally from a fall in our exports of goods and a rise in our imports of goods, nonseasonal changes in services having been relatively small. The

rise in merchandise imports brought their dollar value back to the pre-recession level of early 1949. (See appendix table B-35.)

TABLE 11.—*United States exports and imports of goods and services*
[Billions of dollars]

Period	Exports of goods and services ¹	Imports of goods and services ¹	Surplus of exports of goods and services ¹
1936-38 average.....	4.1	3.6	0.5
1946.....	14.7	7.0	7.8
1947.....	19.8	8.3	11.5
1948.....	17.1	10.4	6.7
1949.....	16.0	9.7	6.2
Annual rates:			
1948—First quarter.....	17.9	10.0	8.0
Second quarter.....	17.3	10.0	7.3
Third quarter.....	16.1	10.9	5.2
Fourth quarter.....	17.0	10.6	6.5
1949—First quarter.....	17.3	10.2	7.1
Second quarter.....	17.8	9.7	8.1
Third quarter.....	14.7	9.4	5.4
Fourth quarter.....	14.0	9.6	4.4
1950—First quarter.....	12.8	10.1	2.8
Second quarter ²	13.2	10.4	2.8

¹ Includes income on investments.

² Estimates based on incomplete data; by Council of Economic Advisers.

NOTE.—Detail will not necessarily add to totals because of rounding.

Source: Department of Commerce (except as noted).

This expansion in the dollar value of merchandise imports in the first part of 1950 continued a movement which had begun with the recovery of United States business activity in mid-1949, before the devaluation of foreign currencies. This is brought out by the monthly figures shown in chart 17. It has taken the form mainly of an increase in the quantity of goods purchased. Despite declining dollar prices, particularly in semimanufactured products, which followed the devaluations abroad, sharply rising world prices for foodstuffs, mainly coffee and cocoa, and subsequent increases in certain raw materials, such as rubber, and semimanufactured materials such as copper, have given average import prices a slightly rising tendency. Upward movements were sharply accentuated by the outbreak of hostilities in Korea.

The additional dollars which the recent rise of imports made available to foreign countries were more than offset by the decline in our foreign aid, which was being provided during the first half of this year at an annual rate about 2 billion dollars lower than in the first half of 1949. (See table 12 and appendix table B-37.) Since foreign purchases from us were considerably below their 1949 levels, however, foreign gold and dollar reserves increased substantially.

The reduction of Government aid in accordance with the reduced needs of foreign countries, and the replenishment of their gold and dollar reserves, are both desirable. Foreign reserves are still below adequate levels. The reduced figure for the net outward flow of American capital in the first

quarter of this year resulted from an accelerated return of short-term capital, as foreign countries repaid commercial debts to us. This bulge in debt repayment is a desirable but temporary phenomenon.

The decrease of merchandise exports brought their value in the first five months of 1950 down 28 percent below the first five months of 1949, and brought their quantity down by 22 percent. The decline has affected nearly all important commodities except cotton, the exports of which have in fact increased. The largest absolute drop, accounting for one-third of the reduction in total exports, was in shipments of certain foodstuffs, namely, wheat and other grains. Among the other commodities most affected were machinery, iron and steel-mill products, automobiles, textiles, coal, petroleum, and tobacco.

TABLE 12.—*Financing the surplus of goods and services supplied to foreign countries*

[Billions of dollars]

Period	Surplus of exports of goods and services ¹	Means of financing			
		U. S. Government sources ² (net)	Liquidation of foreign gold and dollar assets ³ (net)	Outflow of United States private capital ⁴ (net)	Other means of financing ⁴ (net)
1936-38 average.....	0.5		0.8	-0.2	-0.1
1946.....	7.8	5.0	1.9	.4	.5
1947.....	11.5	5.8	4.5	.8	.4
1948.....	6.7	5.1	.8	.9	
1949.....	6.2	5.9		.6	-.3
Annual rates:					
1948—First quarter.....	8.0	5.4	1.3	.9	.4
Second quarter.....	7.3	3.8	2.1	1.2	.2
Third quarter.....	5.2	4.5	.6	.9	-.8
Fourth quarter.....	6.5	6.5	-.9	.5	.3
1949—First quarter.....	7.1	6.7		.7	-.3
Second quarter.....	8.1	6.6	1.5	.5	-.5
Third quarter.....	5.4	5.9	.3	.6	-1.5
Fourth quarter.....	4.4	4.6	-1.8	.6	1.0
1950—First quarter.....	2.6	4.4	-1.9	.3	-.3
Second quarter ⁶	2.8	4.9	-2.8	.8	-.1

¹ Includes income on Investments.

² Includes grants and loans but excludes subscription to the capital of the International Bank for Reconstruction and Development and the International Monetary Fund. For detail, see appendix table B-37.

³ Includes net sales of gold to the United States and net liquidation of foreign dollar assets, including long-term investments. Excludes liquidation of assets held by the International Bank and the International Monetary Fund.

⁴ Includes both long-term and short-term capital but excludes purchase of obligations of the International Bank.

⁵ Includes private gifts, net dollar disbursements by the International Bank and the International Monetary Fund, and allowance for errors and omissions.

⁶ Estimates based on incomplete data; by Council of Economic Advisers.

NOTE.—Detail will not necessarily add to totals because of rounding.

Source: Department of Commerce (except as noted).

The decline of exports appears to have ended in the first few months of the year, and the levels then reached may be maintained or perhaps exceeded in the second half of this year, even apart from any increases that may result from recent international developments.

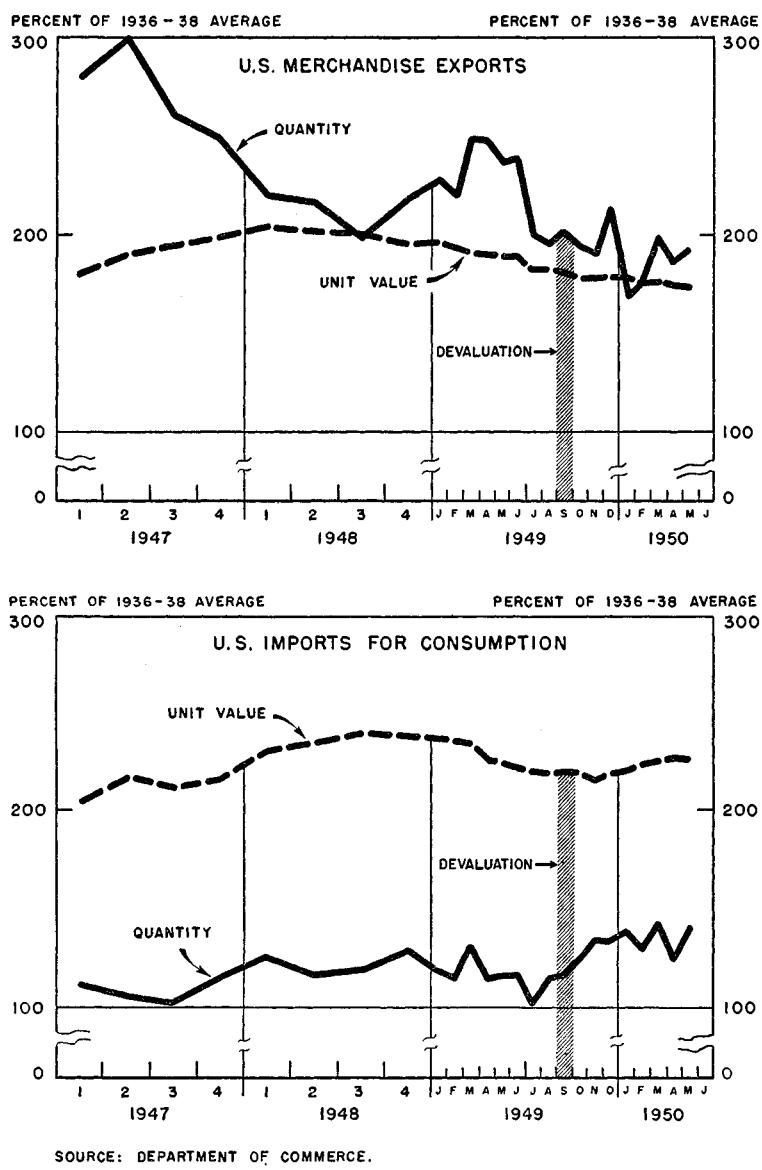
Effects of devaluation on United States foreign trade. The effect of the currency devaluations upon our imports appears so far to have been rela-

CHART 17

EXPORTS AND IMPORTS

QUANTITY AND UNIT VALUE

Both the quantity and unit value (average prices) of exports in early 1950 were below the second half of 1949. The quantity and unit value of imports were higher.



tively limited. Until recently, the average dollar price of our imports was about 5 percent less than in early 1949, though above the June–November 1949 levels. The quantities, except in the case of foodstuffs, are greater. Most of the price decline since early 1949, however, was not attributable to the devaluations, since the declines occurred to a considerable extent before devaluations took place.

The increase in the quantity of goods imported has undoubtedly been given some impetus by the lower values of foreign currencies. But part of the increase since last summer probably reflects the temporarily depressed level of purchases at that time caused by the expectation that devaluation might occur. It is also to be noted, from chart 17, that the quantity of imports, particularly of crude and semifinished materials, began to rise with the recovery in United States business activity, somewhat earlier than can be accounted for by devaluation. Moreover, the sharpest increases in the first few months after devaluation occurred in imports of crude foodstuffs; these increases appear to have resulted largely from seasonal factors, not from devaluation. (See chart 17 and appendix tables B-43 and B-44.)

So far as exports are concerned, shipments of food, semimanufactured and finished manufactured products declined somewhat after devaluation, but in recent months exports of the latter two classes of commodities appear to have recovered slightly, while exports of crude materials are substantially higher than they were in the months preceding devaluation. (See appendix tables B-40 and B-41.)

Prior to the devaluations, many foreign countries were already intensifying restrictions on imports from us in order to stop losses of gold and dollar reserves. To this extent devaluation, by making our goods more expensive abroad, may have been in large part a substitute for direct import restrictions that had been or would otherwise have been imposed, rather than a cause of additional curtailment of our exports. It seems clear, however, that devaluation has contributed to the recent improvement in the dollar positions of many countries by shifting price relationships between goods that foreign countries must pay for with dollars and goods that can be paid for with other currencies.

Changes in areas of total export surplus. The decline in our exports of goods and services to countries participating in the European Recovery Program, their dependencies, and nonparticipating countries in the sterling areas, accounted for nearly one-half of the total reduction in our export surplus of goods and services from the first quarter of 1949 to the same period of 1950. But we maintained a large surplus with Western Europe, and also with Japan. As a result of our lower exports to, and our heavier purchases from other parts of the world, particularly the Latin American Republics, our export surplus with these other major areas was reversed. (See appendix table B-36.) For the first time since the war we developed an import surplus with the Latin American countries as a group, and with the non-European countries in the sterling area. We also had an import surplus

on merchandise trade alone with Africa and Australia, and an approximately balanced merchandise position with Canada for the first time since the war. (See appendix tables B-38, B-39, and B-42.)

This development should not be interpreted as meaning that dollar payments are now purely a Western European and Japanese problem. In the first place, the developments in the first quarter of 1950 may be partly temporary. But more fundamental are two other considerations. One is that the cut in our surpluses with some areas results in part from the enforcement in these areas of more rigorous restrictions by them against imports from the United States. To this extent, the reduction in our export surplus with the world as a whole and with particular areas may mean not that their excess demand for dollars under existing world price relationships has disappeared but merely that it has been suppressed by direct controls of external trade alone, rather than by price adjustments or by excise or other taxes, which would affect both internal and external trade on a nondiscriminatory basis.

The other fundamental consideration is that the existence of a surplus with one area does not mean that dollar payment difficulties, if any exist, are necessarily caused by the trading and financial relations of that area with the United States. A United States export surplus with one area may be normal and desirable; dollar difficulties of that area may arise from inability to earn dollars in other areas. This will depend in part upon its competitive position in other areas and in part upon the volume of dollars which these other areas obtain in the United States through earnings or capital imports. Thus, it is generally believed that Western Europe will continue to import from the United States more than it exports to it after the European Recovery Program ends, and that it can be self-supporting only if it earns gold and dollars in other areas.

Government transactions

NOTE.—As has been customary in previous reports, government transactions are here measured on the so-called consolidated cash basis, rather than in terms of the conventional budget. Cash payments to and receipts from the public reflect the volume of current cash transactions between government, on the one hand, and the public, including business, foreign countries, and international institutions, on the other. All intragovernmental transactions are eliminated. Such data are more useful for assessing the immediate economic impacts of government programs than are the data in the conventional budget. A detailed description of the concepts used is given in the Budget of the United States, 1950, page 1375.

All levels of government combined—Federal, State, and local—directly employed some 10 percent of the total number of civilians employed in the United States during the first half of this year. Government purchases of goods and services represented about 15 percent of the total gross national product. In the field of new construction alone, government activity accounted for 25 percent of the total. Total cash payments by all levels of government, including such transfer payments as old-age pensions, public assistance and unemployment compensation, amounted to a figure nearly one-fourth as large as total gross national product.

These figures indicate the major role played by government in the Nation's economy. In terms of annual rates, total cash payments by all levels of government amounted to about 62.5 billion dollars during the first half of this year, of which the special dividend in repayment of past excessive premiums under the National Service Life Insurance program, computed at an annual rate, accounted for somewhat over 5 billion. Total cash receipts were at an annual rate of about 57.5 billion dollars, or about 5 billion dollars less than cash payments. Quite apart from the relationship between total payments and total receipts, the very large and relatively stable programs represented by these dollar figures exert a major impact on economic developments. (See table 13.)

TABLE 13.—*Government cash receipts from and payments to the public*
[Billions of dollars, annual rates, seasonally adjusted]

Receipt or payment	Calendar year 1949			Calendar year 1950, first half ¹
	Total	First half	Second half	
Cash receipts:				
Federal.....	41.3	41.5	41.2	40.4
State and local.....	16.3	16.0	16.5	17.1
Total cash receipts.....	57.6	57.5	57.7	57.4
Cash payments:				
Federal.....	42.6	42.5	42.9	43.3
State and local.....	17.5	17.3	17.8	19.2
Total cash payments.....	60.2	59.8	60.6	62.5
Surplus (+) or deficit (-):				
Federal.....	-1.3	-1.0	-1.6	-2.9
State and local.....	-1.3	-1.2	-1.3	-2.1
Total, surplus (+) or deficit (-).....	-2.5	-2.3	-2.9	-5.0

¹ Estimates based on incomplete data.

NOTE.—Detail will not necessarily add to totals because of rounding.
Source: See appendix A.

Cash payments by the Federal Government. Excluding the NSLI dividend, Federal cash payments to the public declined from 42.6 billion dollars in 1949 to an annual rate of 38.1 billion during the first half of this year. Including disbursement of the dividend, the annual rate of total payments during the first half was 43.3 billion.

The major explanation for the decline of 4.5 billion dollars in the annual rate of total Federal cash payments (apart from NSLI dividend) to the public lies in the area of international programs, aggregate payments for which declined by some 2.1 billion dollars. This large decline resulted partly from anticipated trends, partly from a repayment to the Treasury by the International Monetary Fund of cash previously received, and partly from a lag of expenditures behind expected schedules. The other major areas of decline were in net cash expenditures for farm price support; and in expenditures for defense, where there was also a lag behind expected schedules, as well as an intensified efficiency drive resulting in a considerable reduction in civilian payrolls.

These and other declines were more than sufficient to bring about a decline in total cash payments (excluding the NSLI dividend), despite a continued very high level of unemployment compensation and public assistance payments and a steady increase in public works. Unemployment compensation payments were at a postwar peak during the first quarter of this year, reflecting the peak unemployment prevailing during those months; and did not decline sufficiently during the second quarter to bring the rate for the half-year below the 1949 level.

TABLE 14.—*Federal cash payments to the public, by type of recipient and transaction*

[Billions of dollars, annual rates, seasonally adjusted]

Classification of payment	Calendar year 1949	Calendar year 1950, first half ¹
Direct payments for goods and services:		
To individuals.....	9.5	9.7
To business and international.....	9.1	8.1
Loans and transfer payments to individuals (excluding NSLI dividend).....	11.4	10.9
Loans, investments, subsidies, and other transfers to business and agriculture.....	6.8	6.0
Loans and transfer payments to foreign countries and international institutions.....	6.2	4.1
Clearing account and adjustment to Daily Treasury Statement.....	-.3	-.7
Subtotal.....	42.6	38.1
NSLI dividend.....		² 5.2
Total Federal cash payments.....	42.6	43.3

¹ Estimates based on incomplete data.

² Total of 2.6 billion dollars for the first half of 1950, expressed as an annual rate.

NOTE.—Detail will not necessarily add to totals because of rounding.

Source: See appendix A.

Cash payments by State and local governments. Incomplete information indicates that cash payments by State and local governments during the first half of 1950 continued their upward trend, running at an estimated annual rate of about 19.2 billion dollars, compared with 17.5 billion in 1949. (See table 14 and chart 18.)

This upward trend reflects the continuing pressure of wartime backlog, large population changes, and a lagging response to the postwar rise in the general level of prices, wages, and salaries.

Federal cash receipts, the cash deficit, and changes in the publicly held Federal debt. Federal cash receipts from the public during the first half of this year were at an annual rate of 40.4 billion dollars, or about 1 billion below the first half of 1949. (See table 15 and chart 18.) This decline occurred despite the 50 percent increase in the rate of employment tax in support of the old-age insurance system, which became effective as of January 1, 1950, and which increased the annual rate of cash receipts by about three-quarters of a billion dollars; and despite a decline of similar magnitude in tax refunds, which produced a corresponding increase in net cash receipts.

There was a sharp drop of over 2 billion dollars in the rate of receipts from the corporate profits tax. Since these taxes are collected with a lag of about one year from the period when the liability actually accrues, this

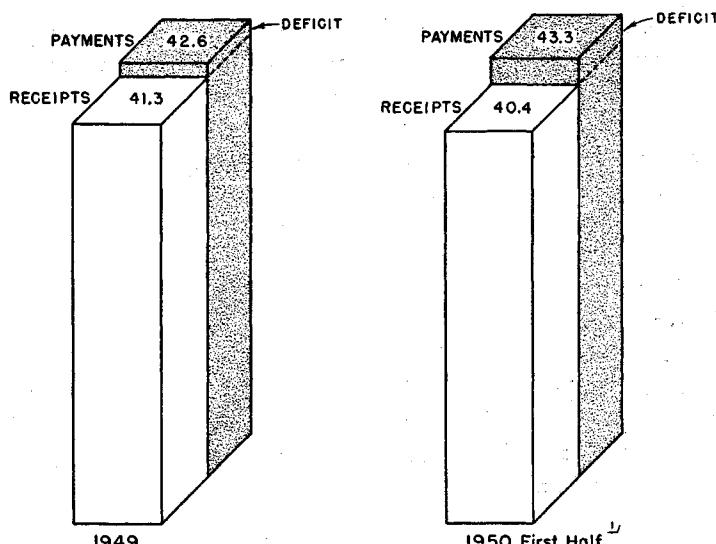
CHART 18

GOVERNMENT CASH RECEIPTS FROM AND PAYMENTS TO THE PUBLIC

The net cash position of the Federal Government showed a deficit of about 3 billion dollars during the first half of 1950, which was more than accounted for by the NSLI dividend. State and local governments continued to show a cash deficit.

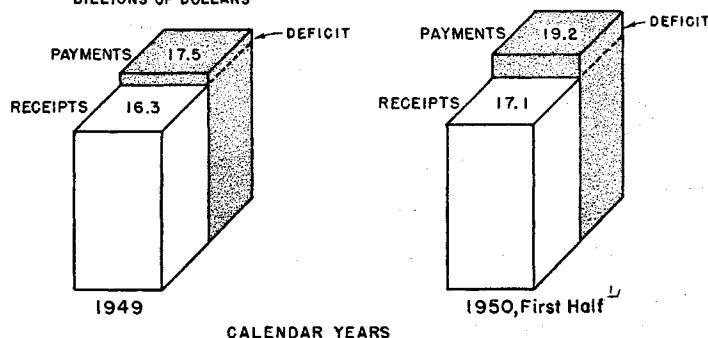
FEDERAL

BILLIONS OF DOLLARS



STATE AND LOCAL

BILLIONS OF DOLLARS



CALENDAR YEARS

^{1/}ANNUAL RATES, SEASONALLY ADJUSTED
SOURCE: SEE APPENDIX A

drop reflected the much lower level of 1949 profits in comparison with 1948. The present high and rising level of profits, with the accompanying increase in tax liabilities accruing, will not be reflected in cash receipts until the first quarter of the calendar year 1951.

The only other category of receipts showing a considerable decline during the first half of this year was that of personal income taxes not withheld, i. e., largely taxes on the incomes of farmers, professional persons, and unincorporated businesses, and on dividends, interest, rents, and other sources of income not subject to withholding. As with corporate taxes, payments during the first half of this year were based in large part on the income levels of 1949. The present rising level of incomes and tax liabilities will not be fully reflected in receipts until next year.

Receipts from surplus property continued their steady decline, and now represent only a minor source of revenue. Other major categories of receipts—personal income taxes withheld, employment taxes, and excises—apart from the increase in the OASI tax rate, and from technical changes in reporting and deposit practices, have shown only very moderate changes over the past 18 months. There was a slight dropping off during the second half of last year, and a roughly compensating increase during the first half of this year. If business conditions continue to improve, this increase may be expected to continue and accelerate.

Excluding the NSLI dividend, Federal cash receipts from the public would have exceeded cash payments, on a seasonally adjusted basis, by about 2½ billion dollars during the first half of this year, compared with the cash deficit of nearly 1½ billion in 1949. Taking into account the very large and rapid disbursement of the insurance dividend during this period, however, the annual rate of total payments exceeded the rate of receipts by nearly 3 billion dollars.

TABLE 15.—*Federal cash receipts from the public*

[Billions of dollars, annual rates, seasonally adjusted]

Source of cash receipts	Calendar year 1949	Calendar year 1950, first half ¹
Direct taxes on individuals	18.4	18.3
Direct taxes on corporations	12.0	9.9
Employment taxes	2.5	3.2
Excises and customs	7.9	7.9
Surplus property receipts5	.3
Deposits by States, unemployment insurance	1.0	1.1
Veterans' life insurance premiums4	.4
Other	1.4	1.4
Less: Refunds of receipts	—2.8	—2.1
Total Federal cash receipts from the public	41.3	40.4

¹ Estimates based on incomplete data.

NOTE.—Detail will not necessarily add to totals because of rounding.
Source: See appendix A.

Apart from the broad trends in the annual rates of receipts and payments, the importance of regular seasonal changes in the relation between receipts

and payments should be recognized. In recent years, there has been a large excess of cash receipts over cash payments in the four months of December to March, and June and September have also shown surpluses. This is due to the relative concentration of tax payments in those months under the present tax laws, and it entails problems of transfer of funds from individuals and corporations to the Treasury and imposes a serious, although temporary, pressure upon the reserves of banks through which the transfers are made.

Following the usual pattern, the concentration of tax payments in the early months of 1950 carried cash receipts high enough to produce a cash surplus of about 1.5 billion dollars in the first quarter of the year, notwithstanding the effects of the business recession of the preceding year and the increase in payments over those of the first part of 1949 arising from the NSLI dividend. April and May were, as usual, deficit months, and June a month of surplus. In the first six months of the year, there was a cash deficit of less than 200 million dollars. The publicly held debt was enlarged by about 1.7 billion dollars from the December 31, 1949 level, and on June 30 was about 219.5 billion. This increase was largely absorbed by individuals and nonbank corporations and associations.

Federal budget receipts, the budget deficit, and changes in the national debt. The foregoing analysis has been in terms of the consolidated cash statement of Government transactions, rather than in terms of the so-called conventional budget. The conventional budget, however, is equally important in many respects. It is the conventional budget with which most businessmen and legislators are chiefly concerned. It is the deficit in that budget which is found disquieting by many whose own decisions about business plans are influenced by pessimistic views about the threat to national credit, and by many legislators in determining their attitude upon a wide range of national economic policies. In the recent postwar years, there has been continuous discussion of the budget, the budget surplus, and the budget deficit, and very seldom has it related to any other than the conventional budget, transmitted by the President to the Congress and reported upon daily in the statement of the Treasury as the fiscal year advances. A budget surplus means a reduction in the national debt, the objective of everyone. A budget deficit means an increase in the national debt. Even though a substantial fraction of this increase may represent a corresponding increase in the assets of Federal trust accounts, businessmen and legislators are concerned about it.

Because of seasonally high tax receipts and a lag in expenditure programs, budget receipts and expenditures for the first half of this year were in close balance, with a budget surplus of nearly 200 million dollars. The balance in the general fund of the Treasury at the close of the half year was 5.5 billion dollars, up about 800 million from the December 31 figure. The increase was more than sufficient to offset the increase of about 200 million dollars in the gross public debt during the half year.

Budget expenditures during the last half of 1950 will be determined by legislative action which has not been completed, and by international conditions which will certainly bring about a large increase in defense expenditures. There is little speculative risk in assuming that economic activity will continue to increase, however, and it is possible to observe the effect upon the trend of budget receipts.

Expanding business is creating larger tax obligations for individual income taxes, for corporation income taxes, and for excise taxes. Not all of these greater liabilities will be represented in increased tax payments this year. Throughout 1950, corporations will be paying income taxes upon profits in the recession year, 1949, and they will not pay taxes upon the higher profits of 1950 until next year. Most individuals who pay taxes upon estimates filed early in the year will not revise those estimates upward on account of the improvement in income occurring in 1950 until near the deadline, which is next January 15.

Federal revenue from excise taxes responds more quickly to improving business, and in the second quarter of the year receipts from this source began to grow. The same trend appeared in the very large item of income taxes paid by employers and withheld from wages of workers. This source of budget receipts accounted for 10.1 billion dollars of Treasury revenue in the fiscal year just closed, and in May and June these receipts were 366 million dollars larger than in the same months of 1949. This was an increase of 20 percent, and reflects the inevitable result of greater employment, higher wage rates, and longer workweeks with overtime pay. The growth of economic activity in 1950 has already been great enough to assure a substantial increase in Federal revenues, an appreciable part of which will be realized in the last half of the year, limiting the deficit which is to be expected in that period of relatively low tax receipts.

Cash receipts of State and local governments; the cash deficit. As was shown in table 13 above, incomplete information indicates that the steady upward trend in the cash receipts of State and local governments since the end of the war continued into the first half of this year. It is estimated that total cash receipts were running at an annual rate of about 17 billion dollars during this period, compared with about 16.3 billion dollars in 1949. Reports on the finances of State and local governments are neither sufficiently complete nor sufficiently prompt to permit an analysis at the present time of the effects of the 1949 decline in business activity.

The steadily rising trend in State and local receipts is a reflection not only of rising economic activity, but also of increased rates in old taxes and of widespread adoption of new taxes. Under the pressure of postwar financial needs, State legislatures have been increasingly disposed both to adopt new State taxes and to grant wider tax authority to local governments, and local governments have been prompt to take advantage of this.

As has been true throughout the postwar period, the increase in the cash receipts of State and local governments was somewhat less than the increase

in cash payments, and the cash deficit rose accordingly. It is estimated that the cash deficit during the first half of this year represented an annual rate of about 2.1 billion dollars, compared with 1.3 billion in 1949.

SUMMARY: THE NATION'S ECONOMIC BUDGET

The economy in the second quarter of 1950 was producing goods and services at a rate of 268 billion dollars per year. This is in the neighborhood of 5 percent above the rate at midyear 1949. Since prices had not changed significantly over-all, the dollar increase approximately reflects the real increase in economic activity by the second quarter. This carries us to a level of activity surpassing that of the second half of 1948. (See table 16.)

TABLE 16.—*Indexes of gross national product, current and constant prices*
[First half of 1948=100, seasonally adjusted]

Period	Current prices	Constant prices
1948—First half.....	100.0	100.0
Second half.....	105.1	101.6
1949—First half.....	101.7	100.5
Second half.....	100.6	100.6
1950—First half ¹	104.9	104.1
First quarter.....	103.9	103.5
Second quarter ¹	106.1	104.9

¹ Estimates based on incomplete data; by Council of Economic Advisers.

Source: Department of Commerce and Council of Economic Advisers.

The rate of increase in production of goods and services from the fourth quarter of 1949 to the second quarter of this year, if continued, would be sufficient to provide full employment before the end of the year.

The Nation's Economic Budget summarizes the main developments in national income and expenditures. (See table 17 and chart 19.) The largest increase in expenditures from the last half of 1949 to the first half of this year, both in absolute terms and percentagewise, was in business investment. Gross investment at an annual rate increased by 10.6 billion dollars or about 33 percent over the period, compared with a rise in consumer expenditures of about 3.6 billion dollars or about 2 percent. Table 18, which is derived from the national economic accounts presented in appendix A, shows the areas in which expansion has taken place.

Most of the increase in private domestic investment is attributable to the swing from inventory liquidation in 1949 to inventory accumulation in 1950, resulting in an increase in effective demand of over 6.5 billion dollars (annual rate). A second important contribution to the increase in private domestic investment was made by a rise of over 25 percent in residential construction over the last half of last year (seasonally adjusted).

TABLE 17.—*The Nation's Economic Budget*

[Billions of dollars, annual rates, seasonally adjusted]

Economic group	1949, second half			1950, first half ¹		
	Re- ceipts	Ex- pendi- tures	Excess of receipts (+) or deficit (-)	Re- ceipts	Ex- pendi- tures	Excess of receipts (+) or deficit (-)
CONSUMERS						
Disposable income relating to current production	169.3			173.8		
<i>Government transfers and net interest payments</i>	<i>16.5</i>			<i>2.22.3</i>		
<i>Disposable personal income</i>	<i>186.0</i>			<i>196.2</i>		
Expenditures for goods and services		179.8			183.4	
<i>Personal savings (+)</i>			+6.2			+12.7
BUSINESS						
Retained business receipts from current production	30.8			28.5		
Gross private domestic investment		31.6			42.2	
<i>Excess of receipts (+) or investment (-)</i>			-.8			-13.7
INTERNATIONAL						
<i>Government loan transfers abroad</i>	.3			-.3		
Net foreign investment		-.3			-2.0	
<i>Excess of receipts (+) or investment (-)</i>			+.6			+1.7
GOVERNMENT (Federal, State, and local)						
Tax payments or liabilities	56.7			59.4		
<i>Adjustment to cash basis</i>	<i>1.0</i>			<i>-2.0</i>		
<i>Cash receipts from the public</i>	<i>57.7</i>			<i>57.4</i>		
Purchases of goods and services		43.0			41.4	
<i>Government transfers</i>		<i>17.6</i>			<i>21.1</i>	
<i>Cash payments to the public</i>	<i>60.6</i>			<i>62.5</i>		
<i>Excess of receipts (+) or payments (-)</i>			-.9			-5.0
ADJUSTMENTS						
For receipts relating to gross national product	-2.8			-2.8		
<i>Other adjustments</i>	<i>-.3</i>			<i>+.8</i>		
Total: Gross national product	254.1	254.1		265.2	265.2	

¹ Estimates based on incomplete data. See appendix A for first half 1949.² Includes 2.6 billion dollars (5.2 billion at an annual rate) of the nonrecurrent payments on the NSLI dividend.

NOTE.—Items relating to current production of goods and services are shown in roman type. Transfer payments and receipts and subtotals including them are in italics; they are not included in the gross national product. Detail will not necessarily add to totals because of rounding.

Source: Based on data from the Department of Commerce and Bureau of the Budget. (See appendix A.)

Outlays for producers' durable equipment were somewhat higher in the first half of this year and in the second quarter increased substantially, thus reversing the downward movement which had taken place since the 1948 peak.

The increase in consumer goods purchases can best be appraised in connection with a somewhat more detailed view of the receipts side of the Nation's Economic Budget. (See table 19.)

CHART 19

THE NATION'S ECONOMIC BUDGET

Business investment rose about $10\frac{1}{2}$ billion dollars (annual rate) from the last half of 1949 to the first half of 1950. Consumer expenditures increased about $3\frac{1}{2}$ billion dollars, which was much less than the increase in disposable income.

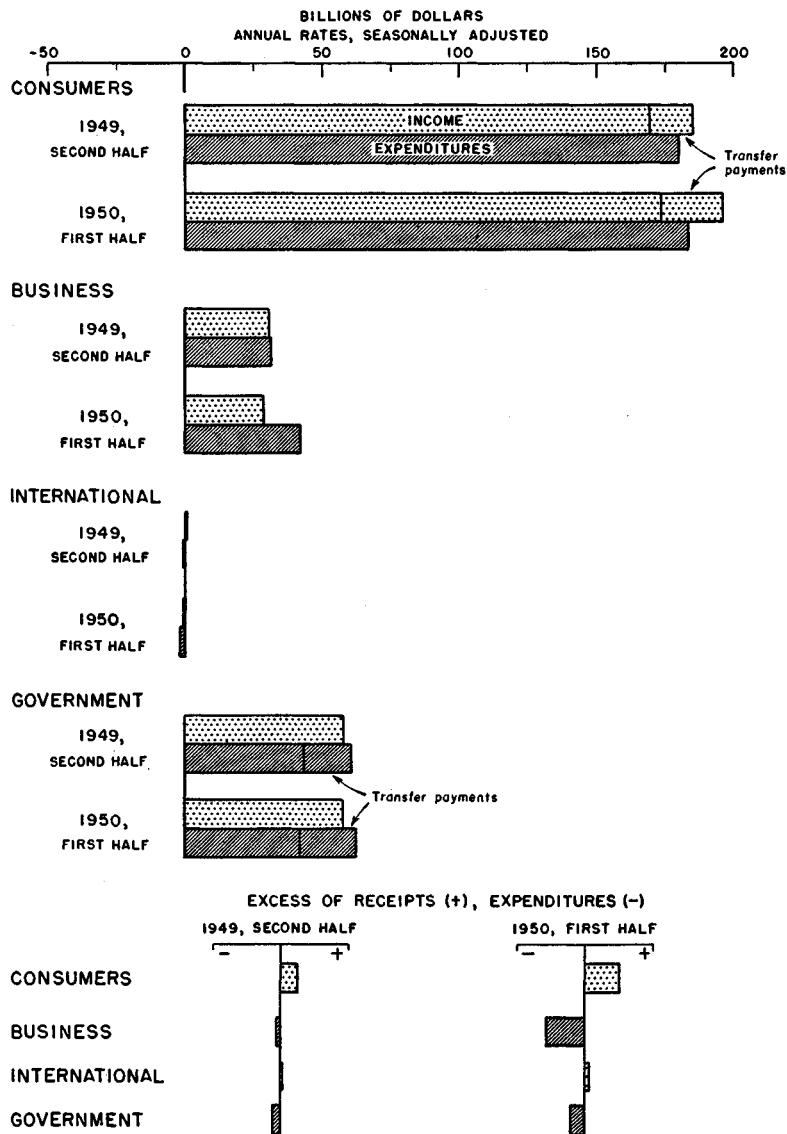


TABLE 18.—*Change in selected expenditure items of the Nation's Economic Budget*

Expenditure items	Change from 1949, second half to 1950, first half ¹	
	Billions of dollars ²	Percent
Consumer expenditures		
Durable goods	+3.6	+2.0
Nondurable goods	+2.0	+8.0
Services	+.2	+.2
Services	+1.4	+2.5
Gross private domestic investment	+10.6	+32.5
Construction	+2.7	+15.4
Residential (nonfarm)	+2.4	+27.0
Nonresidential	.3	+3.5
Producers' durable equipment	+1.4	+7.4
Change in inventories	+6.6	
Government cash payments to the public	+1.9	+3.1
Federal	.4	.9
NSLI dividend	+5.2	
Other	-4.8	-11.2
State and local	+1.4	+7.9
Total gross national expenditures	+11.1	+4.4

¹ Based on preliminary estimates for 1950, second half.² Annual rates, seasonally adjusted.

Source: See appendix A.

TABLE 19.—*Change in selected receipt items of the Nation's Economic Budget*

Receipt items	Change from 1949, second half, to 1950, first half ¹	
	Billions of dollars ²	Percent
Disposable personal income		
Government transfer payments and net interest	+10.2	+5.5
NSLI dividend	+5.8	+35.2
Other	+5.2	
Income from current production	+.6	
Wages and salaries	+4.7	+3.6
Farm income	+3.2	+2.5
Other income	-.3	-2.4
Less: Personal taxes	+1.8	+4.4
	.2	+1.1
Business receipts		
Corporate profits before tax	-2.3	-7.5
Inventory valuation adjustment	+2.2	+7.9
Capital consumption allowances	-3.8	
Less: Corporate taxes and dividends	+.7	+3.6
	+1.5	+8.1
Cash receipts from the public		
Federal	-.3	-.5
State and local	-.3	-1.9
	.6	+3.6
Total receipts relating to gross national product	+11.1	+4.4

¹ Based on preliminary estimates for 1950, first half.² Annual rates, seasonally adjusted.

Source: See appendix A.

In the first half of this year, disposable income of consumers exceeded the rate of the last half of 1949 by about 10.2 billion dollars or over 5 percent. About half of this increase is attributable to the payment of the veterans' dividend, computed at an annual rate. However, income derived from current production, particularly wages, business and profes-

sional incomes, dividends and rental incomes, increased by nearly 4.7 billion dollars or about 2.5 percent. Only farm incomes showed a continued decline.

The fact that disposable personal income increased by 5.5 percent, and consumer expenditures by only about 2 percent, may in part be explained by the behavior of veterans who used a considerable portion of their dividend for payment of outstanding debts, to accumulate liquid assets or to make payments on new homes. Another part of the dividend was used for the purchase of durable goods, sales of which increased by 8 percent in the first half of 1950 over the second half of 1949. The proportion of expenditures devoted to durable goods was higher than in any previous period, postwar or prewar. Expenditures for nondurable goods increased scarcely at all. The disparity between the increase in durable and nondurable expenditures may reflect in part the nonrecurring special payments to veterans during the first half of the year.

The same factors that are reflected in the expenditure and receipt sides of the Nation's Economic Budget also affect the relationship of saving and absorption of saving. (See the third and sixth columns of table 17.) The increases in personal saving and in the Government cash deficit are both inflated by the receipt or payment of the veterans' dividend during the first six months of this year, which appears to be doubled when counted at an annual rate. Excluding the veterans' dividend, the combined cash deficit of Federal, State and local governments (expressed as a seasonally adjusted annual rate) shows a substantial decline from the second half of 1949.

The large increase in the excess of business investment over retained corporate receipts reflects the increase of funds spent for residential construction and especially for inventory accumulation. While several factors were of significance in the expansion of the last six months, inventory movements were outstanding. This was true even before international events gave a new impetus to further inventory accumulation.

This analysis of the Nation's Economic Budget indicates that the expansion of the last six months has rested not only upon the shift from inventory liquidation to accumulation, and upon the payment of the extraordinary veterans' dividend, but also upon factors of more lasting duration. Prior to the Korean development, it was to be expected that the economy, during the rest of the year, would continue to move towards maximum employment and production in a steady manner. Since then, the request for additional military appropriations, and greatly accelerated consumer and business buying, have resulted in an increasing threat of shortages, price increases, and other inflationary developments. It is with these most recent developments, and the prospect of further developments initiated by the changed international situation, that public policy must now concern itself.